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The role of regional capital markets in enhancing resource mobilization and in promoting their efficient use

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Acronyms and abbreviations

ADR	American Depositary Receipts
ASEA	African Stock Exchanges Association
ASEAN	Association of South-East Asian Nations
BEIA	Ibero-American Electronic Stock Exchange
BIS	Bank for International Settlements
BOLCEN	Asociación de Bolsas de Comercio de Centroamerica
BOVESPA	Bolsa de Valores de São Paolo
CAF	Andean Development Corporation
CARICOM	Caribbean Community
CNV	Comisión Nacional de Valores (National Securities Commission, Mexico)
COSRA	Council of Stock Market Regulatory Authorities of the Americas
DAE	Dynamic Asian Countries
ECA	Economic Commission for Africa
ECDC	Economic Cooperation among Developing Countries
EEA	European Economic Area
EU	European Union
ECOWAS	Economic Community of West African States
FIABV	Ibero-American Stock Exchanges Federation
FIBV	Fédération Internationale de Bourses des Valeurs
GCC	Cooperation Council of the Arab States of the Gulf
IASC	International Accounting Standards Committee
IDR	International Depositary Receipts
ILDIS	Instituto Latinoamericano de Investigaciones Sociales
IFC	International Finance Corporation
IOSCO	International Organization of Securities Commissions
LARF	Latin American Reserve Fund
LDCs	Least Developed Countries
NASDAQ	National Association of Securities Dealers Automated Quoting (US)
MERCOSUR	Southern Cone Common Market
OECD	Organization for Economic Cooperation and Development
OTC	Over-the-counter (market)
PER	Price-earnings ratio
RDC	Central American Depositary Receipts (Recibos de Depósito Centroamericanos)
SEAQ	Stock Exchange Automated Quotation System (London)
SEBI	Securities and Exchange Board of India
SEC	Securities and Exchange Commission
SENN	Sistema Eletrônico de Negociação Nacional (Brazil)
WAMU	West African Monetary Union

Summary

1. This report analyses some of the major issues of mobilizing domestic and regional resources through existing and potential regional capital markets. Chapter I puts the issues in a general context and discusses the justification for a regional capital market network.

2. Chapter II of the study analyses the role of capital markets in the mobilization of resources. It evaluates (section A) the multiple facets of emerging markets and their participation in the process of globalization and regionalization of capital flows. Section B reviews the role of capital markets as segments of national financial systems.

3. Chapter III discusses the regional capital markets network and attempts to detect areas where action is necessary. 1/ Section A highlights the similarities between the domestic capital market integration in countries with decentralized capital market structures and the potential regional capital market integration. Section B surveys the role of market participants and actors involved in regional capital markets' activities. Section C assesses the level of sophistication and technological progress of these markets. Section D reviews the fundamental issues in legislation, supervision and taxation related to the establishment of regional capital markets.

4. Chapter IV is devoted to the proposals for establishing and/or strengthening domestic capital markets as a step towards the creation of a regional network among them, and to the measures that would foster regional capital markets. Section A deals with the practical actions at private and public level to be adopted in that direction and gives a hint about changes to be introduced in the regulatory context. Section B surveys the regional harmonized actions required to foster regional capital markets. Finally, some ideas are included in section C related to potential technical cooperation activities for assisting the regional capital market initiatives of developing countries.

5. A preliminary conclusion drawn in this study is that countries should undertake the necessary changes in order to enhance regional capital markets, that is, the improvement of information channels; the adoption of regional convertibility; the enhancement of the role of clearing houses in the regional settlement of transactions; the liberalization of capital accounts; and harmonization of the fiscal, supervisory and regulatory policies with a view to encouraging cross-border securities trading.

I. GENERAL ISSUES

6. Since the mid-1980s, there has been a rapid expansion of investments in some developing countries both in the form of portfolio equity and foreign direct investment (FDI). The rise in investments is explained, from the investors' viewpoint, by the structural changes in international capital markets 2/ and, from the host countries' point of view, by the structural reforms carried out by developing countries.

7. As a result, there has been an increase in the number of instruments issued by developing countries to raise resources drawn from international capital markets. In addition, the number of companies from these countries issuing securities in foreign markets and the volume of private capital flowing into some developing countries have substantially increased.

8. The gains stemming from this flow have not been equally distributed. The growth of investments has benefited the so-called emerging markets countries 3/ that have been successful in carrying out policies conducive to growth and to strengthening the operational framework for local stock markets. This means that the least developed countries (LDCs) have been left behind with limited amounts of new capital inflows; the same applies to both portfolio equity and FDI.

9. In this regard, it is useful to review the experience of emerging capital markets as the only group of developing countries having developed a relatively sophisticated financial system in the service of their expanding internal markets. It is a commonly shared view that new countries (with nascent domestic stock markets) should learn from the experience of emerging capital markets how to access domestic, regional and global resources and fulfil the conditions that have made emerging markets an attractive investment opportunity.

10. The conditions of the growing number of emerging capital markets cannot be, *stricto senso*, applied to all developing countries. Nevertheless many developing countries wishing to diversify their financing resources by, inter alia, developing their local securities markets may take advantage of the experience and financial facilities gained by countries that have been able to develop domestic stock exchanges in the same region and establish regional capital networks.

11. The goal of developing capital markets originally emerged in the 1980s in response to the scarcity of external resources encountered by developing countries and a desire to rely more on local sources for funding economic development, particularly in the form of *non-debt creating financial flows*. 4/

12. This paper examines the rationale for regional capital markets. It discusses the steps involved in the process of nurturing security markets and regional capital cooperation. The latter would involve, inter alia, the modernization and integration of national financial systems, encouraging the development of national stock exchanges, the establishment of cross-border banking facilities and complete openness to all financial services.

13. Often studies dealing with capital markets focus on the establishment and/or improvement of securities markets in the context of national economies and the ways to prepare them for participation in the global financial network. Usually the problems relate to the small size of national economies, resulting in the limited offer of tradeable shares and the vulnerability of the markets and, by virtue of lack of depth, lack of resistance to outside shocks originating in large external capital markets.

14. Solutions offered to solve these problems, in the domestic context, have not always provided effective remedies. There is no immediate or easy way to increase the size of developing countries' capital markets to a level comparable with larger capital markets. The supply of tradeable domestic equity may be increased only within the modest limits of the small individual economies.

15. Noting that capital markets have not typically developed at par with economic activity, this study attempts to introduce the often neglected aspect of regional cooperation into the proposed fostering of equity and debt financing. A World Bank paper analysing individual capital markets concluded 5/ in the same vein, that the imperative of regional capital market cooperation is now evident in developing countries. For example, in the Andean Group, an ongoing research project 6/ aims at formulating proposals for the integration of capital markets in the Andean subregion as a mechanism for strengthening the process of savings-investment and economic growth.

16. The tentative findings of this study indicate that regional cooperation may hold the key to solving many of the problems associated with both nascent and emerging national capital markets. The regional scale may provide local stock exchanges with the necessary market size for viability both in cost and volume. In addition, it may also strengthen the developing country's capacity to resist the adverse effects of changes in international capital markets and, finally, it may help in the mobilization of resources in countries and within social groups where such is not otherwise possible. The benefits of financial integration may also include: (a) better allocation of capital flows among the countries, resulting in higher gains and benefits; (b) a reduction in incentives spurring capital flights; and (c) fostering regional FDI and joint investments.

17. The proposals to foster regional capital markets elaborated in this study are also in line with the current views on regional integration. In fact, the global trend towards revitalization of economic integration after the debt crisis of the 1980s has been characterized by a broadening of the concept of integration. The regional/subregional integration process is becoming multi-faceted and not just exclusively focused on commercial integration. It is generally accepted that, for commercial integration to be successful, it must be complemented by a range of other measures, among which are the following elements:

(a) Cooperation in the sectors often neglected in the past, especially the development and the diversification of production capacities;

(b) The establishment of networks of industries serving both regional and global markets;

(c) The development of cross-border infrastructure and communications networks;

(d) The setting up of marketing and distribution cooperation through more direct and frequent contacts among economic operators;

(e) The establishment of efficient monetary and financial structures for capital market development, and

(f) The strengthening of multilateral clearing and credit arrangements charged with settling trade and non-trade transactions along with capital market development.

18. While this study does not intend to analyse the theoretical debate about the role of securities markets in the domestic economy, it holds that the impact of such markets is positive for the following reasons: first, they mobilize financial resources from within and outside the countries; secondly, they contribute to a more efficient allocation of financial resources, thus saving on the cost of finance and pooling of risk; thirdly, they standardize financial practices and norms and contribute significantly to transparency of information; fourthly, they open up possibilities of international financial linkages, and fifthly, while integrated capital markets might be a source of instability, the positive side of the ledger seems to outweigh this risk.

19. The need for the inclusion of capital market development in the current agenda of regional cooperation is thus clearcut. For small countries facing difficulty in creating their own domestic capital markets, such cooperation would provide a threshold of market viability and entry. In addition, it can enhance shareholding practices (buying and selling of shares) scarcely existing at present and can provide an improved channel for financing regional joint ventures and projects. The possibilities presented in this paper may serve to furnish ideas for discussion by developing countries with a view to formulating appropriate collective action proposals. Such proposals should include, among other suggestions, the coordination of the private and public sectors at regional level.

20. Arguments for regional capital markets may be formulated also from the point of view of market participants. For both intra- and extra-regional investors, they would provide opportunities for the diversification of portfolio risks; this could be in form of enlarged investment possibilities. Thanks to more standardized and widespread information on listed securities and to more reliable pricing of available equities, regional capital markets would also entail renewed access to highly profitable equity which was earlier considered to be too risky. For intra-regional enterprises, they would provide access to an extended pool of financial resources and a more optimal localized service, depending on their preference for carrying out equity financing in local and/or intra-regional resources.

21. As a result of the similarities in the general conditions of countries with more advanced emerging markets (emerging in its narrower sense) and those with nascent capital markets, the experience of the former is considered in this study as a prototype for the latter. The stage of development of the different markets depends on many factors; some of them stimulate capital markets growth while others hinder it. Among the factors catalyzing growth, the process of deregulation is important; among the factors hindering capital market development, too rigid controls stand out rather starkly.

II. CAPITAL MARKETS AND MOBILIZATION OF RESOURCES: THE SCOPE FOR FINANCIAL INTEGRATION

22. For a long time, the establishment of national stock exchanges in developing countries was hindered by several factors such as, the weakness of their national income, the lack of national savings and the prevalence of State-controlled economies through national holdings and State companies. Furthermore, the financial system of these countries relied essentially on recourse to borrowing through national and international lending institutions, thus giving no impulse to the establishment of securities markets.

23. In the mid-1980s a combination of different elements created a more favourable environment for the establishment of stock markets in these countries. Among the motivating factors was the necessity to transcend the debt crisis caused by several years of excessive external borrowing. Recourse to a national banking system and to development of alternative sources of financing thus was sought. Another element was the rapid economic growth experienced by the developing countries. This led to the emergence of a supply of net domestic savings in search of worthwhile investment opportunities in the newly established stock markets.

24. Emerging markets have rapidly grown over the past few years. Their sometimes extremely high rates of returns have attracted many international investors and fund managers. Conversely, these spectacular high returns have often been accompanied by important risks owing to the extreme volatility of the emerging stock markets. 7/

A. Emerging markets in the global financial system

25. Perhaps it is a good starting point to dwell upon emerging capital markets and their attempts to develop a functioning structure and regulations as a prelude to the discussion of regional capital markets. The assessment of the emerging markets in the global financial system offers the ideal backdrop for a further analysis of their efforts towards regionalization; they may serve also as a prototype for cooperation schemes, including nascent securities markets. In this respect, both their general position in the global marketplace and their common and diverging features deserve attention.

1. General situation

26. Emerging securities markets accounted for about 6.4 per cent of global market capitalization in 1991, 7.7 per cent in 1992, and 9.0 per cent in 1993 (see annex I, table 1). 8/ As far as their participation in cross-border and cross-exchange equity trading flows is concerned, their share in 1991 was estimated to be 7.2 per cent (see table 1).

Table 1

The geographical distribution of the British private sector's overseas equity portfolio in 1913 as compared with the geographic composition of global cross-border and cross-exchange equity trading in 1991

British overseas equity portfolio, 1913		Global cross-border equity trading, 1991	
"Emerging markets"	**43.2%**	**Emerging markets**	**7.2%**
Asia and Africa	19.7%		
Eastern Europe	3.4%		
Latin America	20.1%		
Developed markets	**56.8%**	**Developed markets**	**92.8%**
Australasia	11.1%	Australasia	3.4%
Western Europe	2.4%	Western Europe	46.2%
North America	33.7%	North America	25.0%
Japan	1.7%	Japan	18.2%
South Africa	2.8%		
Rest of the World	5.1%		

Source: Baring Securities [1993]

27. This marginal role is yet at variance with the optimism evident in certain forecasts which see an enlarged role for emerging markets in the future global financial marketplace. 9/ It is argued that in the next century, emerging markets will regain the position similar markets lost in the first half of the twentieth century. In 1913, the capital invested in markets which could be characterized as emerging, represented 43.2 per cent of the average overseas equity portfolio in the British private sector (see table 1), while only 56.8 per cent of the assets were invested in what corresponds by today's terminology to developed markets. If emerging markets are to regain their lost share in global capital flows soon, then the relative shares of the early part of the century could serve as a rough guide to a global investment structure for the year 2000 and beyond.

28. Under this scenario, cross-border equity flows will again be concentrated in the areas of emerging growth, such as Latin America and Asia, with a decline in developed economies such as those of Europe or Japan. This forecast, however, merits some qualifications because great technological changes have occurred since the early twentieth century and intra-firm relations have become determinant elements of cross-border investment; hence the analogy should not be overstated.

29. Although the possibility of reaching a share of almost half of the global equity flows in the near future may be argued, nevertheless several factors in cross-border capital flows show that emerging markets are increasingly important. Such optimism is based on the similarities between the features of

the current global market and that of trade of the last century. Apart from the scale of trading, other characteristics listed in table 2 also prevailed at the turn of the century.

Table 2
Similarities in cross-border capital flows
between the late nineteenth and twentieth centuries

	Late 19th century	Late 20th century
1. Capital flowing to emerging markets	yes	yes
2. Portfolio flows most important source	yes	yes
3. Banks and industrial corporations least important cross-border investors	yes	yes
4. Capital raising occurs in global money centres (cross-exchange listings increase)	yes	yes
5. Cross-border trading dominates new money flows	no	yes

Source: Baring Securities [1993]

30. The first common characteristic, the increased importance of capital movements to emerging markets is evidenced by South-East Asia's and Latin America's relative success in this field. At the beginning of the 1990s, the South and South-East Asian countries continued to be active in the international equity portfolio market (with their country funds), in the international bond market and the market for international private loans. At the same time, after several years of absence, certain Latin American countries (Mexico, Chile, Argentina and Venezuela) have staged a successful comeback into these markets. Their presence in international markets (albeit concentrated in a limited group of developing countries) may prepare the ground for other developing countries and country groupings to try to gain access to these markets.

31. The second feature common to the beginning and end of the twentieth century is the dominant role of portfolio over direct foreign investment in cross-border financial flows. Portfolio investment represented 75 per cent of global flows in 1991 as compared with only 15 per cent from 1975 to 1979. Within this sub-total, comprising both debt and equity, the share of equity portfolios rose from 5 to 36 per cent over the same period.

32. A third common feature of the late nineteenth and twentieth centuries has to do with the dominance of institutional investors (pension, life insurance and mutual funds) in the markets while banks and industrial corporations were the least important cross-border investors. While the latter face domestic regulatory constraints and are characterized by a conservative policy of

investment in developing countries, the former are eager to profit from their improved risk management techniques and from the high returns promised in certain emerging markets.

33. The expansion of emerging markets is facilitated by the fact that important amounts of capital can be raised in global money centres. There is also an increasing number of cross-exchange listings. In 1992, Thailand itself floated 14 country funds in six international centres (London, New York, Tokyo, Singapore, Hong Kong and in Australia), with a value of US$ 1.29 billion. The increase in cross-exchange listings is also evidenced by the fact that in stock markets such as Amsterdam, Luxembourg and Switzerland (Zurich, Basle and Geneva), the number of listed foreign companies has already exceeded that of traded domestic corporations. Other important centres of foreign listings are Germany, London, US NASDAQ 10/ and Paris.

34. Unlike the similar features characterizing the beginning and the end of the century, a new current phenomenon of our time is the dominance of cross-border trading in new money flows. For 1991, Baring Securities estimated global capital (gross equity) flows to be US$ 2.1 trillion. 11/ In this total, the relative importance of international equity trading continues to rise. For example, in 1991, one equity transaction out of every five involved either foreign shares or foreign investors, as compared with one out of every 16 in 1979. Because corporations prefer equity financing rather than debt instruments, they can benefit from the increase in global equity flows.

2. Diverging and common features of emerging markets

35. The group of emerging capital markets is however a very heterogeneous one. The term emerging markets refers to capital markets of all the developing countries (including Turkey), except Hong Kong and Singapore; 12/ all economies in transition as well as those of the People's Republic of China, Greece, Portugal.

36. The term however could be misleading for two reasons. First, it is applied both to newly created markets, 13/ such as Bahrain, Ghana, Panama and Slovakia and to long-established ones, such as those of Rio de Janeiro (created in 1845), São Paulo (1890) and Bombay (1887). Secondly, the term does not seem to imply defining characteristics because it applies to the following groups of countries:

First group: 14/ Mexico, Republic of Korea, Taiwan Province of China, Thailand and Malaysia. These countries and territories share several common characteristics with developed markets including low inflation, relative stability of exchange rates, developed domestic financial and banking systems; easy access to international bond and equity markets; important trading volumes in stock exchanges; and relatively sophisticated securities compensation and trading systems. If this first group of emerging markets is not yet considered to be on the same level as the developed ones, it is because they have not been able totally to consolidate their achievements or to eliminate their vulnerability to changes in the global market. Also, as an indication of domestic economic problems, these markets have not been able to overcome the difficulties faced by small and medium-sized domestic enterprises in

order to fulfil the listing requirements of large internationalized companies.

Second group: 15/ (emerging markets in a narrow sense): Brazil, Argentina, India, Philippines, Nigeria. These are countries that, according to the *IFC Emerging Stock Markets Factbook*, 16/ have already embarked on the road to qualitative change, expansion in size and sophistication, in contrast to markets which are small and show little appearance of change. If the latter are still underdeveloped it is probably because of the low volumes of transactions and the small values of market capitalization.

Third group: in a broader sense, the term emerging market applies to any other country that is not part of the group of developed market economies; this includes developing countries and territories, countries in Central and Eastern Europe, members of the Commonwealth of Independent States and other countries within the former Union of Soviet Socialist Republics, in addition to socialist countries in Asia. Typical examples of this group are Guatemala, Ecuador, Barbados, Côte d'Ivoire, Ghana, the Russian Federation, etc. Because of their current economic problems, these countries have unsatisfactory economic performance, little access to international private capital flows and are generally *in a nascent stage* of capital market development even when compared with the typical emerging markets.

37. Emerging capital markets share various characteristics which underline the importance of regional cooperation. Nevertheless, in other aspects like the importance of bond markets or the *velocity of turnover*, 17/ their diversity makes it impossible to formulate general conclusions.

38. Usually, emerging markets are less developed and more volatile than their developed counterparts. The relatively riskier parallel and derivatives (options and futures) markets 18/ are either less advanced in developing countries than in the industrialized world or do not exist at all. Parallel markets exist in Amman, Istanbul, Kuala Lumpur, Manila and Taiwan, Province of China. Although their level of development may allow their being introduced in Mexico, Brazil or Chile, this has not yet occurred. As far as futures and options are concerned, the most developed East Asian and Latin American markets are in the phase of feasibility studies or implementation. 19/

39. As shown in a sample of emerging and developed markets presented in table 2 in annex I, in terms of *market capitalization per GDP* (indicator of the depth of domestic securities markets), emerging countries and territories, with the exception of Malaysia, Chile and possibly Taiwan Province of China, are not comparable to their developed counterparts. Their average (32 per cent) is less than the corresponding indicator for the United States (65 per cent) and the United Kingdom level (94 per cent). In certain countries, such as Ghana, Hungary, Peru and Tunisia, market capitalization per GDP is below the level of 5 per cent. The low level of deepening in emerging markets may reflect the lack of access for small- and medium-sized companie to listing and trading.

40. The experience of developing and Eastern European countries is distinguished by great differences regarding the relative importance of the

bond market in securities trading (see table 2 in annex I). In countries facing fiscal deficits (such as Chile, Mexico), the use of debt instruments is essential; in countries that tend to run budget surpluses (such as Thailand, Indonesia, Republic of Korea), there is only a small amount of tradeable government debt. In between there are several countries that maintain a balance between equity and bond instruments.

41. In terms of *turnover velocity* (see table 2 in annex I), emerging markets show extreme variety. As they are relatively new markets with less established market capitalization levels, their average turnover velocity is faster (44 per cent) than that of their developed counterparts (43 per cent for the United States, 20 per cent for Japan). Within this average range, there are very "fast" markets such as Taiwan Province of China (235 per cent), Republic of Korea (108 per cent), Thailand (126 per cent) and Turkey (86 per cent), and very "slow" markets like Ghana (less than 1 per cent), Côte d'Ivoire (1 per cent), Costa Rica (1 per cent), Cyprus OTC (2 per cent). It is an important feature that all the "fast" markets are at a relatively advanced level of stock exchange development and all the "slow" markets are at a nascent stage.

42. The relative importance of new issues as compared with secondary trading (relative capacity to mobilize new resources) is high both in nascent markets (Cyprus OTC, Côte d'Ivoire) and in dynamic ones (Thailand, Republic of Korea, Taiwan Province of China, Mexico). This is explained by the status of the secondary market and the demand for new issues (limited number of long-established companies in secondary trading, reticent secondary market as a reflection of volatility and important demand for new issues).

43. In an average emerging market, an important indicator of investors' confidence is the *price-earnings ratio* which at 18 is lower than in most of the developed markets (see table 2 in annex I). However, in both categories, a great diversity exists. On the developed side, Spanish markets had a ratio of less than 10 in 1992, the Netherlands only 11 and Switzerland only 13 while Toronto reached a level of 156.5, Sweden 60, the NASDAQ and Japan 37. In the case of emerging markets, the lowest confidence indexes were registered in Brazil (8), the Republic of Korea (11) and Turkey (11) while the highest marks went to Argentina (40), Taiwan Province of China (23) and Malaysia (23).

44. The concentration of trading in top companies, reflecting the vulnerability of markets, is markedly higher in developing securities exchanges than in the OECD area, for example. On average, in an emerging stock exchange, only 17 companies account for 64 per cent of the value traded and 60 per cent of market capitalization. In Argentina, for example, nine companies accounted for 62.5 per cent of value traded and 68.5 per cent of market capitalization. In Thailand, 16 companies represented almost half (47 per cent) of the value traded and more than two-fifths (43 per cent) of market capitalization.

45. Although from time to time domestic authorities express fears over loss of control over securities trading as a result of excessive internationalization, in reality, emerging markets are much less internationalized than their developed counterparts. If data for FIBV members are taken into consideration, Kuala Lumpur was the only emerging market which had foreign companies (3 of them) listed on it in 1992. In turn, there was no

developed market without at least one foreign company listed on it. The data for certain emerging markets on the share of foreigners' transactions in value traded and foreigners' ownership in market capitalization, as presented in table 2 of annex I, do not show grounds for fears over loss of control.

46. In such nascent markets as those of Ghana and Sri Lanka, foreign ownership and foreigners' transactions stood at one half and one fifth, respectively. Foreign investors accounted for one quarter of the transactions in Indonesia and for one-fifth of trading in Mexico. Therefore, selective internationalization and, particularly, intraregional integration have scope for further development.

B. Capital markets and financial systems

47. Capital markets are a dynamic part of the domestic financial system in their home countries. They are closely related to banks and other financial intermediaries of the formal financial sector and loosely connected with informal (and semi-informal) activities.

48. Financial circuits consist of formal and informal sectors which, in most cases, follow competitive and complementary activities. Of the institutions of the formal sector, only central banks and treasuries do not have counterparts in the informal sector. In the field of capital-market activities, the official stock, bond, money and foreign exchange markets compete for the same resources with the collective investment activities of friends, neighbours, relatives, rich individuals as well as rural financial markets, informal foreign exchange markets and informal investment companies.

49. In the case of officially recognized capital markets, various segments may co-exist. The most important element of this market is the institutionalized segment in the form of a securities/stock exchange. Although in most cases the rest of the market is built around the stock market, there are cases (Cyprus, Saudi Arabia) where an over-the-country (OTC) market may exist without a stock exchange.

50. Stock exchanges are often divided according to the object of trading, such as equities, bonds, futures, options or foreign exchange market. Sometimes they are also divided into different tiers, the first one being reserved for big enterprises and the second one, with looser criteria, for small- and medium-sized companies. Furthermore, stock exchanges may coexist with parallel and/or OTC markets. Some of the latter, such as the NASDAQ in Atlanta and the *SEAQ* 20/ in London already handle highly sophisticated international electronic trading of company shares of various countries. The parallel markets of developing countries (e.g., Malaysia, Singapore, Thailand) are not yet internationalized.

51. In most countries, banking sectors and capital markets can be clearly distinguished from each other. Usually, commercial banks are not allowed to engage directly in securities trading. They are obliged to employ intermediaries or to act though their affiliates registered as securities brokers. Only countries with wide universal banking traditions (Germany, Switzerland) allow banks to deal with securities trading.

1. The re-evaluation of capital markets

52. The perception of the importance of capital markets in the financial growth of developing countries was re-evaluated in the 1980s. Before, only an ancillary role had been reserved for the financial system in allocating resources. This sector was not seen as a major source of employment or innovation, but rather as a tool to be used by the authorities in the goal of structural transformation.

53. The underdevelopment of financial markets also affects the management of monetary policy as it hampers open market operations and indirect controls on interest rates. Monetary authorities have been confined to using direct controls, changes in reserve requirements and refinancing facilities to achieve their policy aims. Furthermore, financial systems have been characterized by a high degree of segmentation. Each type of financial institutions has been limited to its explicitly assigned domain. Entry of new institutions into particular segments has been vastly regulated or prohibited.

54. In the 1980s, a move toward financial liberalization began worldwide. This shift was based on the fact that strong controls and regulations were found to be increasingly unsuitable for resource allocation and for securing satisfactory economic growth. Too strictly regulated financial systems had a negative impact on the economy, creating distortions in investment decisions and in intermediation between savers and investors. In many developing countries, rigidities in the financial systems precluded the attainment of the goals of the increasingly complex and sophisticated economies. Deregulation was also prompted by the growing realization that direct controls on international capital flows had become less effective over time. The growth of the Euromarkets, the development of new financial instruments and technological progress have been noticeable examples in bypassing restrictions.

55. In general, the financial liberalization of the 1980s entailed more reliance on market forces and more efficient monetary policies. Reforms implied the liberalization of interest rates, the reduction of credit controls, more competition in the financial system, the reinforcement of supervision and the deepening of financial markets, accompanied by more flexible exchange rate arrangements and a relaxation of restrictions on external capital flows. Within this framework of general financial liberalization, emerging markets, particularly in Latin America, are undergoing major changes. Capital markets are expanding substantially in countries where Governments envisage to embark on privatization programmes through the stock exchange, as in the case of Brazil, or introduce private provident funds (pension funds) as in Chile, and improve stock market regulation.

56. In all cases, including those of the nascent African stock exchanges, the basic goal in the financial markets is the introduction of policies that avert market disturbances without hindering the development of the market and measures which may lead to channelling various segments (pension funds, privatization, government bonds, new issues by companies, both domestic and international) through the securities market.

2. The regional dimension of financial systems

57. Financial liberalization has also its regional dimension and consequences. The free movement of capital paves the way for more intensive intra- and interregional financial flows. These flows are as important for the process of integration as the free movement of goods and services.

58. Establishing financial integration entails that national, intra-regional and, eventually, interregional capital would benefit from a similar treatment. Thus, the coordination of some aspects of economic policies, particularly in such areas as the monetary and exchange rate policies and financial and credit regulations is required.

59. The harmonization of monetary and financial policies is thus an important issue in the broader process of integration. Evidently, at national level, the harmonization should be in line with the adjustment programmes that countries undertake. At regional level, it should entail creating a forum where Governments would agree on its main aspects.

60. The relationship between fiscal policies and this harmonization is complex. While in principle fiscal policies can remain independent, in reality, tax harmonization is necessary in financial integration. Furthermore, the ability of Governments to finance budgets by borrowing from the Central Bank has to be either suspended in monetary unions or subject to strict union-wide rules.

3. The role of provident/pension and other investment funds

61. The diversity of financial markets is not surprising. A less known feature, however, is whether some special institutions (e.g. provident/pension funds) may play a significant role in the mobilization of resources.

62. The Employee Provident Fund in Malaysia, with a non-market related rate of return on funds, and the Central Provident Fund in Singapore, with a market-based rate of return, both help to increase the savings rate and hence the overall rate of capital accumulation. 21/ If the surpluses of social security funds are well managed and efficiently invested, they can also facilitate the promotion of financial markets 22/ through investments in bonds and equities.

63. In Chile, the high growth of the domestic capital market in the 1980s is explained by the activities of institutional investors, particularly pension funds. 23/ Between 1980 and 1991, the assets of pension funds increased from zero to 10 billion United States dollars while the capital of other funds (mutual funds, insurance companies and foreign capital investment funds) increased from 1 billion to 4 billion United States dollars. Owing to a previous legal prohibition, equity investment in companies listed in the Bolsa de Comercio de Santiago appeared first in the portfolio of pension funds only in 1986 but had already reached a share of 24 per cent by 1991. In other countries, such as Mexico, Brazil and Argentina, similar plans for the modernization of pension funds and their more active role in the capital market are under consideration.

64. In some developed countries, provident funds play an even more significant role in channelling resources to private equity. Moreover, these funds offer examples of massive cross-border (equity) investment and its benefits. In 1991 alone, United States funds invested US$ 43.3 billion (approximately 40 per cent of global equity flows) into overseas equity. 24/ As of March 1992, the top 10 United States pension funds kept 5.6 per cent (US$ 25.5 billion) of their assets in foreign securities (of which 4.5 per cent in equity and 1.1 per cent in bonds). In the case of United Kingdom pension funds, the share of overseas equities in total assets increased from 6 to 21 per cent between 1979 and 1991.

III. REGIONAL CAPITAL MARKETS NETWORK: MARKET PARTICIPANTS AND ACTORS, FUNCTIONING STRUCTURES AND REGULATIONS

65. Experiences of capital market integration are still at a nascent stage. Their implementation would require institutional cooperation and the harmonization of regulations regarding capital market development. Based on the experience of local integration of stock exchanges, the actions required in a process of regionalization of capital markets activities are examined herewith.

A. Domestic integration of capital markets in countries with decentralized stock markets structures

66. As a first attempt towards analysing how stock exchanges of different countries may cooperate, it is worth examining the processes of integration carried out by domestic capital markets in countries that traditionally have had decentralized structures. 25/ This phenomenon parallels the case of cross-border trading. As it takes place in the same country, cooperation of domestic capital markets is, however, easier than regional cooperation since the former does not require previous harmonization of diverging national regulations and does not face foreign exchange problems.

67. One example of decentralized domestic capital markets is that of India, where there are 20 local stock exchanges with independent trading floors 26/, and an OTC market in Bombay with a national range of trading in the biggest companies of the country. The cumulated number of companies listed at least in one of the 20 stock exchanges was estimated at 6,200 at the end of 1990, compared with 581 in Brazil, 669 in the Republic of Korea and 199 in both Mexico and Taiwan Province of China. Market fragmentation explains why, in 1993, the Indian Government approved a plan to create by March 1994 a national stock exchange based on nationwide computer-based trading in equities, bonds and commercial papers. While such a system does not abolish the present-day trading floors, it may result in the syphoning off of the most important companies from traditional exchanges.

68. Brazil is another example of decentralized capital markets. The country has nine local exchanges. 27/ Except São Paulo, the national leader, which has its own modern, fully computerized trading network and integrated custody and settlement system, eight stock exchanges are integrated into the SENN system (Sistema Eletrônico de Negociação Nacional) which allows trading simultaneously with the open outcry sessions on local trading floors.

69. While in India and Brazil the trend is to integrate the originally separated stock exchanges, Nigeria is an example of trading started on one floor (Lagos, in 1961) which was transformed into a single stock exchange with three floors (Lagos, Kaduna and Port Harcourt, in 1977) and has continued its decentralization with the opening of three new floors (Ibadan, Kano and Onitsha) since then.

70. Though the road followed by India, Brazil and Nigeria has been different, the final result shows certain convergence: **a move towards a single national securities trading institution that realizes its operations on various floors belonging to it.**

71. The process of creating a uniform domestic network of stock exchanges in Brazil, India and Nigeria has benefited from some favourable factors which are rarely present (and therefore, should be reinforced) in the case of potential cross-border cooperation and actions among capital markets. These factors include: (a) the use of a common currency which facilitates the execution and clearing of transactions; (b) a common legal basis; (c) harmonized regulations; (d) a uniform telecommunication network, which facilitates networking in stock exchange transactions; and (e) a tradition of interconnections and joint operations.

B. Market participants and actors involved in regional capital market activities

72. In the 1980s, the methods of fostering economic development underwent important changes. Until then in most developing countries a preeminent role had been reserved for the State and its direct intervention. Emphasis has now shifted to the role of non-governmental actors with reforms being brought to bear on the regulatory and monopoly practices which impede the private actors from fully contributing to development.

73. This process of enlarging the scope of major players in international cooperation has been particularly pronounced in the financial area. In the case of capital-market cooperation, such reforms are in line with the general character of the activities of capital markets. Each segment can function smoothly only if the roles of regulators, supervisors, intermediaries and players reflect an optimum design of the financial system. Hence, it is incumbent on any analysis to examine and classify the roles and characteristics of market participants.

74. The economic agents involved in the regulation and operation of domestic and regional capital markets are diverse. They may be categorized as private and public, domestic and regional (and international) actors. (See table 3). It is worth noting that domestic stock exchanges and OTC markets influence the regulation and operational aspects of regional capital markets.

1. *Domestic private actors*

75. Any scheme envisaging the establishment of regional capital markets should take into consideration the point of view and interest of market actors (consensus-building among all interested market agents). In most countries, stock exchanges may be clearly distinguished from the banking sector. In contrast, the parallel and OTC markets, particularly in countries which adopted the universal banking model, may be dominated by commercial banks and/or their securities trading affiliates. There are three major types of domestic private actors involved in capital market operations. The most important ones are securities (stock) exchanges, the parallel and the OTC markets.

76. Stock exchanges play a far-ranging role in domestic and regional capital markets in the sense that they combine, at the same time, the functions of (a) an association of traders (brokers); (b) a service institution for investors; and (c) a self-regulatory market, particularly in secondary trading.

Table 3
Actors involved in domestic and regional capital markets activities

	PRIVATE	PUBLIC
DOMESTIC	· Stock exchange and OTC market · Custody, settlement and clearing institutions · Listed companies, brokers, investors · Telecommunication service companies	· Central Governments · Central monetary authorities · Domestic supervisors · Tax and legislative authorities
REGIONAL	· Intra-grouping organizations and cooperation schemes of stock exchanges · Global cooperation organizations among stock exchanges (FIBV)	· Cooperation schemes among intra-grouping supervisory authorities (e.g. COSRA), clearing and payments arrangements · International agencies (IOSCO, IASC)

77. If a country has capital account convertibility 28/ the authorization to engage in cross-border trading of shares and bonds as well as the cross-border listing of intra-grouping companies may depend only on an autonomous decision of the stock exchange 29/.

78. The second prominent group of domestic private actors consists of domestic custody, settlement and clearing institutions. In countries without central domestic institutions, settlement and clearing are executed by commercial banks.

79. The third major group of domestic private actors includes listed companies, brokers, and individual and institutional investors. If any intra-regional trading is envisaged, it would aim at serving their interests. Finally, any project envisaging regional capital markets will imply the participation of private telecommunication service companies in the establishment of acceptable communication links among markets and market actors.

2. Regional private actors

80. Concerning regional private arrangements and organizations, the most important are the schemes created by the securities markets themselves. Once the minimum regulatory requirements are met, it is up to private domestic actors through their cooperation arrangements to perform cross-border listing and trading. For example, in a cooperation arrangement between Argentina and Brazil, the legal framework for cross-border transactions was created by supervisory agencies. In turn, the prospect of trading in both specific Argentine enterprises on the São Paulo Stock Exchange and the stocks of certain Brazilian companies on the Buenos Aires Stock Exchange was made

possible by an agreement signed in 1992 between the two stock exchanges. Supervisory agencies participated only in the selection of the companies.

81. The most important private regional cooperation schemes of developing countries are the *Caribbean Stock Exchange* and the *Ibero-American Electronic Stock Exchange (BEIA)* project.

82. The *Caribbean Stock Exchange* (see box 1 for details), operational since 1991, is a mechanism of cooperation among the existing stock exchanges of the Caribbean Community (CARICOM) integration group. 30/ It is not a new concentrated trading floor or a new physical organization. It consists of cross-border trading through correspondent broker relationships (for data, see annex I, table 3) and potential cross-border listing. Capital market cooperation in CARICOM is particularly stimulated by the small size of the domestic economies and their capital markets (see annex I, table 4). However, in view of certain problems faced by this regional stock exchange, some actions for future development have being proposed - see box 2.

83. The *Ibero-American Electronic Stock Exchange (BEIA)* project (see box 3) was created in 1990 by members of the Ibero-American Stock Exchanges Federation (FIABV). FIABV includes all the major Latin American stock exchanges as well as those of Portugal and Spain. BEIA's final aim is to process electronically trading in major regional enterprises. Intra-regional trading will be facilitated by settlements through central banks. In its first phase, bilateral agreements are signed between member stock exchanges (the current status of bilateral agreements is summed up in annex I, table 4) and a unified information and intercommunication system is established. In a second phase, domestically listed companies may apply for listing in the BEIA network. In a third phase, BEIA will become a multilateral electronic trading system backed by the telecommunication services of LATINET. 31/

84. In Central America, the *Association of Central American Stock Exchanges (BOLCEN)* is at the stage of preparing far-reaching intra-grouping projects (see box 4). The *Union of Arab Stock Exchanges*, the *East Asian and Oceanian Stock Exchanges Federation* (established in 1982 and includes Japan) and the *African Stock Exchanges Association* (ASEA, established in April 1993 and includes South Africa) have also as their basic objective the harmonization of and cooperation in securities trading in their respective regions. The two latter share the characteristic of grouping both developed and developing markets. This is also true in the case of the Ibero-American Stock Exchanges Federation.

85. The organization for the cooperation of stock exchanges at global level, called *Fédération Internationale des Bourses de Valeurs* (FIBV), with its aim of intensifying collaboration among member stock exchanges and the development of securities markets, influences regional markets indirectly. In 1988, FIBV issued its *Generally accepted principles with respect to securities trading* and, in 1992, its *Generally accepted principles of securities business*, aimed at a global standardization of the principles of securities trading. FIBV also has a long-term cooperation arrangement with the Ibero-American federation (FIABV).

Box 1

CARIBBEAN STOCK EXCHANGE (CARIBBEAN COMMUNITY)

The integration of capital markets in CARICOM was mandated in clause 5 of the Grand Ansee (Grenada) Declaration, issued at the 10th Heads of Government Conference in 1989.

The term "*Caribbean Stock Exchange*" refers to the integration of operations among the three existing Stock Exchanges of the Caribbean Community (CARICOM): *Barbados, Jamaica and Trinidad and Tobago*. It does not imply trading concentrated in one physical place (participant stock exchanges have kept their separate trading floors) or a new physical organization. The Caribbean Stock Exchange consists of two elements:

(1) Since 1 January 1991, any company incorporated in any of the three participant countries has been allowed to apply for listing in any of the three Stock Exchanges, on condition that it meets the listing requirements of the stock exchange in question.

(2) Since 8 April 1991, any citizen of these three territories has been allowed to trade in any shares in any of the three stock exchanges mentioned.

The *accomplishments* of the Caribbean Stock Exchange have been the following:

(1) *Cross-border listing*. Up to the end of 1992, no application for cross-listing was registered.
(2) *Cross-border trading* has more visible results. It is conducted with the help of correspondent broker relationships. Citizens of one country wishing to purchase shares in another country place their order with their local broker. This local broker sends the order to his counterpart at the stock exchange of the country of investment. The order is thus executed by the correspondent broker. The investor has now the responsibility to produce the foreign exchange required for the purchase of the above-mentioned shares. In the network of the Caribbean Stock Exchange, only United States dollars are accepted for cross-border investment.

In the period of April 1991 to April 1992, Trinidadian investors were actively trading in Barbadian stocks, while Barbadian and Jamaican investors showed interest in securities of the Trinidad and Tobago Stock Exchange. Compared with the period ending on 31 December 1991, cross-border trading decreased significantly in the first four months of 1992. Moreover, during this latter period, investors reduced their intra-CARICOM cross-border exposures. Net Trinidadian investment on the Barbados Stock Exchange and net Barbadian investment on the Trinidad and Tobago Stock Exchange decreased mildly and stayed within the range of US$ 3.9 million and US$ 2.2-2.4 million while Jamaica's net exposure in Trinidad and Tobago was reduced from US$ 3.9 million to US$ 3.5 million (an 11 per cent decrease). In other relations (Barbados to Jamaica, Jamaica to Barbados, Trinidad and Tobago to Jamaica) trading was nil or negligible.

Box 2

CARIBBEAN STOCK EXCHANGE: THE SCOPE FOR FUTURE ACTIONS

Current situation:

(1) Communication channels are too slow and unevenly developed for a timely flow of required general economic, company or trading information.
(2) Withholding and other taxes are not harmonized among participant countries.
(3) Because cross-border investments are settled in US dollars, there is a permanent demand for foreign exchange in participant countries.
(4) The Caribbean Stock Exchange is not open to the companies and investors of the other 10 CARICOM members.

Directions of possible future development:

(1) The widening of investment possibilities for individual and institutional investors in participant countries, especially for pension funds and life insurance companies ("deepening of capital market integration").
(2) The tapping into a larger pool of savings in participant countries ("deepening of capital market integration").
(3) The use of the Caribbean Stock Exchange mechanism for the financing of regional joint venture projects ("deepening of capital market integration").
(4) The use of national currencies in the settlement of transactions once currency liberalization in individual countries makes it possible ("regional" or "limited convertibility").
(5) The opening of the participants of the Caribbean Stock Exchange for investors from the other 10 CARICOM member countries ("widening of capital market integration").
(6) The opening of the participants of the Caribbean Stock Exchange for the listing of companies registered in the other 10 CARICOM member countries. While most of these countries are too small to establish a separate stock exchange on their own, their enterprises may show particular interest in raising funds on the existing stock exchanges ("widening of capital market integration").
(7) The incorporation of new members in the Caribbean stock exchange mechanism. Although the other 10 CARICOM members generally are too small for the opening of new stock exchanges, some of them (e.g. the Bahamas or the east Caribbean States that otherwise share a common currency) may find merit in creating a new one. Moreover, other countries that have a stock exchange may one day join CARICOM and show an interest in cooperation with its stock exchanges ("widening of capital market integration").

Box 3

THE BEIA PROJECT

The Rio de Janeiro Stock Exchange presented at the 17th General Meeting of the Ibero-American Stock Exchanges Federation (FIABV) held in Bilbao, Spain, in 1990, its Latin-American Electronic Stock Exchange (BELA) project. With the inclusion of Spanish and Portuguese Stock Exchanges, the project was renamed the Ibero-American Electronic stock exchange (BEIA) in the same year. BEIA intends to handle trading in the securities of major enterprises in the Ibero-American region, therefore creating a broader market for raising of funds for these companies. In the BEIA network, all transactions are processed electronically and settlements are made via the Central Banks of the countries involved in the transaction.

The realization of the BEIA project is divided into three phases. In the first one, members of the FIABV sign bilateral agreements with each other. In this stage, participants have to create a unified system of information and inter-communication in order to pass, buy and sell orders from one country to another. In the second phase, if this system is ready, member Stock Exchanges may start to list in the BEIA some of those companies that are already listed locally. At a later stage, the inter-connected members can form a multilateral electronic trading system among themselves.

Beside the interested stock exchanges, participation should also include central banks, the securities and exchange commissions (SECs), the Cajas de Valores (organizations of custody, clearing and settlement), the brokers and the investors of interested countries, as well as an enterprise of telecommunications services. In the case of BEIA, this role is played by LATINET, a subsidiary of Consultoria, Métodos, Assessoria e Mercantil Ltda (Brazil), which is a long-term associate of the Rio de Janeiro Stock Exchange.

A Committee of representatives from Buenos Aires, Madrid, Mexico City and Rio de Janeiro has examined the feasibility of the BEIA proposal and has found bottlenecks caused by such economic policy measures as legislative divergences concerning equity markets, foreign exchange regulations and taxation. In September 1991, FIABV members discussed the feasibility study of BEIA, prepared by a consultant. On the basis of this study, a global information system among member stock exchanges was proposed.

The first cross-border listing under the framework of the BEIA project (an issue of 100 million US dollars for Yacimientos Petrolíferos Fiscales/YPF of Argentina on the Brazilian capital market, organized by the Sistema Eletrônico de Negociação Nacional (SENN), was scheduled for the second half of 1993.

3. Domestic public actors

86. Among the domestic public actors, *central governments* play an important role both as agents that create the general economic framework of securities trading - domestic and cross-border - and as players in regional capital markets with the placement of bonds in other countries of the region. For example, at the beginning of 1993, US$ 150 million worth of Venezuelan government bonds were issued and sold on the Colombian stockmarket (see box No. 5).

Box 4

BOLCEN'S AGENDA FOR THE 1990s

At the ordinary assembly of the Association of Central American Stock Exchanges (BOLCEN), held in 1992 in Panama, proposals were presented for the creation of Central American Depository Receipts (RDCs) and harmonization of listing requirements. The project on the RDCs, certificates issued by a trust fund ("fideicomiso") giving title to a number of shares in given Central American companies, had been conceived by the Bolsa de Valores de Panamá, the Corporación Privada de Inversiones de Centroamérica and the Federación de Entidades Privadas de Centroamérica y Panamá. The shares in question will be deposited and kept in custody while the certificates are traded among foreigners. RDCs are designed to stimulate trading in US dollars on the secondary market for Central American securities denominated in local currencies.

BOLCEN members have decided also to facilitate their electronic interconnection and the mutual use of their Centrales de Valores for the custody of deposits from each other. The statutes of BOLCEN were reviewed in order to adapt them to new members of the Board of Directors and to include a code of the basic principles of transparency and fairness of markets. In addition, Central American countries are examining the feasibility of a Central American currency market. As proposed by the Bolsa de Valores de Panamá and accepted by the Costa Rican business community, the first currency to be traded in this market may be the Costa Rican colón.

87. Governments may also play a leading role in giving preferential treatment to intra-grouping investors. A typical example of government measures favouring intra-grouping securities investment is the non-reciprocal preferential scheme of Bahrain. It offers the scheme to GCC investors as a support to initiatives for cross-border trading of the Bahrain Stock Exchange. Since 1986, citizens of other Gulf States have been allowed to own and trade shares of local companies in Bahrain. 32/

88. In the MERCOSUR area, intra-grouping preferences are offered by member Governments on a mutual basis. Although certain restrictions (limitation to spot market, trading in listed stocks and intra-MERCOSUR settlement), and certain tax limits are kept, intra-grouping securities trading is liberal (see box 6).

Box 5

THE PUBLIC OFFERING OF VENEZUELAN GOVERNMENT BONDS IN COLOMBIA (1993)

The simultaneous placement of US dollar-denominated Venezuelan government bonds in the Colombian market and in the international capital market, launched 5 March 1993, is the first experiment of a bond issue placed within the regional context. The issue, amounting to 150 million US dollars, was listed in the Bolsa de Bogotá, the Bolsa de Medellín and the Bolsa de Occidente in Colombia and on the Luxembourg Stock Exchange. The Colombian market was chosen by the Government of Venezuela because of its relative stability and favourable international rating. The coupon (interest rate) applied to this Venezuelan regional/euromarket issue is slightly higher than that applied to the most recent international bond issue of this country. According to available international data for emerging markets (see table below), the Venezuelan issue bears the second highest interest rate after that of the Banco do Brazil.

Public debt issues by "emerging" countries, denominated in US dollars, January to August 1993

Issuer	Date of issue	Maturity	Amount (US dollars million)	Interest (Coupon), percentage
Republic of Argentina, 2 tranches	02.08.93	02.08.96/ 02.08.2000	100/ 150	8.25/ 6.875
Banco do Brazil	14.04.93	14.04.98	100	10.5
Republic of Colombia	04.93	04.98	125	7.125
Czech National Bank	06.04.93	06.04.96	300	7.00
National Bank of Hungary	10.06.93	10.06.98	150	8.00
Republic of the Philippines	23.02.93	23.02.96	150	7.825
Republic of Venezuela (the Colombian/international issue)	05.03.93	05.03.96	150	9.125
Republic of Venezuela	27.05.93	27.05.96	150	9.00

Source: JP Morgan, Euromoney

Box 6

THE REGULATION OF INVESTMENT ON BRAZILIAN STOCK EXCHANGES BY MERCOSUR RESIDENTS

Since 29 January 1992, individuals and/or legal entities domiciled or headquartered in Argentina, Brazil, Paraguay and Uruguay (the countries that signed the MERCOSUR Treaty) have been permitted to invest freely on each other's stock exchanges.

In Brazil, investors from countries outside the MERCOSUR area are allowed to invest on the local stock market only through investment funds or portfolios. They also face foreign-exchange control measures, licensing requirements and restrictions for physical persons. In contrast, as stipulated in CMN (National Monetary Council) resolution n° 1901 of 29 January 1992, individuals and legal entities of other MERCOSUR countries can invest on the Brazilian stock market without having to resort to investment funds or portfolios, or face the controls applied to other foreign investors.

In Brazil, the only remaining restrictions on investment in domestic securities by MERCOSUR residents are that:

(a) transactions must be carried out only on the spot market;

(b) only registered stocks must be traded for MERCOSUR investors;

(c) investors must be domiciled and headquartered in the country of origin of their investment; and

(d) transactions must be settled on the financial markets of the countries of the parties involved in the transaction.

Investments may be made in: (a) US dollars; (b) the currency of the country of origin of investment; or (c) the currency of the country receiving the investment.

The greatest obstacle still left to investment in Brazil is that physical persons residing in other MERCOSUR countries are obliged to pay 25 per cent taxes on dividends and 25 per cent taxes on capital gains, in contrast with the tax exemption of institutional investors.

89. A second important group of domestic public actors are the *central monetary authorities* that play a key role in the regulation of settlement for cross-border transactions. In the case of MERCOSUR and GCC, intra-grouping transactions are treated liberally, leading to a *de facto* regional capital account convertibility area while in CARICOM the issue of convertibility has not yet been solved. In the BEIA project, *central monetary authorities* are viewed as agents of transaction settlements that link domestic securities clearing and settlement schemes.

90. The third group of domestic public actors are *domestic supervisors* (securities and exchange commissions) as well as tax and legislative authorities which are crucial both to cross-border harmonization of rules and to discretionary treatment of intra-grouping investors/companies.

91. To summarize, stock exchanges can initiate cooperative arrangements for cross-border listing and trading in securities as long as the legal requirements are satisfied. The role of public actors consists of setting the legal requirements for trading qualifications, the standards for securities, the methods of settlement, foreign-exchange payments and the tax regulations therein.

4. Regional public actors

92. Among the public actors at regional level, prominent status is accorded to the cooperation schemes of supervisory authorities. In the Andean Group, the Latin American Reserve Fund (LARF) 33/ sponsors the dialogue among these agencies. On 10-12 March 1993 in Lima, Peru, the domestic supervisory authorities and the stock exchanges of the Andean Group discussed possible ways of harmonizing their capital markets, with a view to increasing cross-border capital flows among member countries. The standards of operation and the tax treatment in these markets were among the chief topics on the agenda.

93. As far as the Americas are concerned, the *Council of Stock Market Regulatory Authorities of the Americas (COSRA)* was established in Cancún, Mexico, in 1992, with the objective of creating uniform accounting and taxation standards.

94. On the global scene, the *International Organization of Securities Commissions (IOSCO)*, and the *International Accounting Standards Committee (IASC)* are the two organizations that indirectly influence the creation of regional capital markets, both developed and developing, with their standards and recommendations. These standards and recommendations are described in detail in chapter IV, section B.

C. Sophistication, technological advancement

95. Stock market automation is another important precondition of regional capital markets as it creates the hardware and the software which will transmit, execute and clear cross-border transactions in securities. Moreover, the existence and cooperation of automated and compatible systems may facilitate the goal of intra-grouping trading. Such technological upgrading induces both benefits and costs.

96. Some of the advantages that an automated system may offer are:

(a) Increased efficiency through prompt information distribution and the sharing of expensive electronic clearance and settlement equipment, 34/

(b) Enhancement of global competitiveness through improved operations,

(c) Amelioration of market surveillance by signalling irregularities to organized markets and regulatory bodies,

(d) Multiplication of the trading volume through computerized channelling and matching of orders, of price determination, and of clearing and settlement.

97. Conversely, the extent of systemic risks is also boosted with intensified trading volume and faster operations. Therefore, regulatory difficulties should be prudently evaluated to ensure that the management of systemic risks can be maintained with the smallest regulatory gaps possible.

98. The level of automation shows great diversity in emerging markets. São Paulo, for example, has an advanced computer trading system developed by the Toronto Stock Exchange. Mexico installed a completely automated trading system in May 1993. The Rio de Janeiro, Republic of Korea, Singapore, Taiwan Province of China and Thailand stock exchanges have custody, clearing and settlement systems comparable to those of the most advanced markets in the world. The global competitiveness of the Rio de Janeiro clearing system was evidenced by its ability to establish a similar modern system in Porto and Lisbon. In Singapore and Thailand, clearing and custody are executed by two separate bodies while in Rio de Janeiro and in the Republic of Korea, they are concentrated in one organization (see table 6 in annex I).

99. In contrast with the highly automated markets, in most developing countries, including Hong Kong and Indonesia, where the stock exchanges have a relatively important market capitalization, further developments to improve both the trading and clearing and settlement systems have not yet occurred. 35/ In Africa, generally the degree of automation considerably lags behind other developing countries.

D. Regulatory aspects of regional capital markets in developing countries

100. The progress of regional capital markets would depend on several factors that either stimulate or hinder capital market development at national level. Among the factors stimulating capital markets, measures of deregulation deserve particular attention; among the factors hindering them, the lack of flexibility vis-à-vis stock markets seems to be the most serious hurdle. Regulation is thus of primary importance in capital market development.

101. The *regulation* of capital markets may take the form of:

(a) *Regulation of markets by government authorities* (a securities commission, a government ministry, or a central bank) either through laws, and/or direct government controls or management of the markets, especially regarding new issues (primary market), or

(b) *Self-regulation* by the markets themselves, through the stock exchange with the Government's role confined to oversight only. This is particularly widespread in secondary trading in relatively developed markets. 36/

102. Regulation has many facets. The most important regulatory issues of securities markets which directly affect cross-border activities are related to taxation, legislation (basic laws), the design of supervisory agencies (regulations) and capital account liberalization.

103. Capital regulations of securities firms seek to ensure that these institutions can withstand periods of crisis or failure of a large customer. In contrast to banks, securities activities are subject to extensive public

disclosure requirements to protect investors from fraud and to ensure an efficient allocation of capital. 37/

104. In the case of firms in emerging capital markets, the progress on regulatory aspects is worth noting. The following subsections examine regulatory aspects and evaluate them from the point of view of potential regional cooperation.

1. Taxation

105. The appropriateness of taxes is one of the key elements of both domestic capital market development and the stimulation of foreign investment in domestic securities. Moreover, every regional cooperation scheme should encourage the harmonization of the taxation of intra-grouping trade.

106. Despite the need for harmonization in tax matters, there are few signs of progress in this field in developing countries. Table 7 in annex I sums up the typical dividend, interest and capital gain taxes of selected non-OECD countries and Turkey at the end of 1992. According to these figures, taxes diverge within the same country from item to item (capital gains, dividend, interest), as well as among countries. 38/ There is hardly any harmonization even among members of the same integration grouping. Regional preferential treatment is almost non-existent. Moreover, certain countries apply very high taxes that may discourage both domestic and cross-border securities trading.

2. Issues in legislation

107. As regards legislation, the most relevant issue for the development of domestic capital markets and their potential regionalization is a clear legal framework (securities trading law) in each country, accompanied by other laws (for example, company laws) and decrees that unambiguously specify the rules of securities trading.

108. As far as developing and transition countries are concerned, they combine advanced elements of legislation with less advanced ones. Table 8 of annex I reviews the case of 12 countries where the legal background of securities trading is more or less settled.

109. Among the 12 countries of the sample, 2 (Bahrain and Panama) regulate securities trading by decree. Ghana has a relatively old stock exchange act which is under revision in a draft Securities Industry Law. India has one of the oldest laws, the Securities Contracts (Regulation) Act that dates back to 1956. The Brazilian Capital Markets Law is almost three decades old. The newest legislation in this list includes the Capital Market Law of 13 May 1992 in Turkey and the Securities and Exchange Act of 16 March 1992 in Thailand.

110. Thailand, with its new Securities and Exchange Act offers a good example of improved legislation for a more transparent, efficient and effective supervision of securities business. The new law, confined to primary markets (new issues) created one-agency supervision, left secondary trading self-regulated by the Stock Exchange of Thailand and the OTC market, and has recognized warrants and convertibles as new market instruments.

111. In other countries, the legislative framework is not yet as well developed. In Indonesia, for example, securities trading is regulated by a Presidential Decree of 1990 which separated the supervisory agency from the stock exchange. Another example of pending legislation is Trinidad and Tobago's Securities Industry Act and Companies Act, under discussion in 1993.

3. Supervisory agencies

112. Attempts towards the regionalization of capital markets may be successful if this process is not disrupted by irregularities in some of the participating countries. This implies close cooperation among well-established and well-functioning supervisory agencies in the fight against local and cross-border irregular behaviour (e.g. insider-trading, fraud).

113. For this reason, the review of the current status of the institutional structures of capital market supervision deserves attention. The emerging markets form two distinct groups: countries which follow the one-agency model and markets with fragmented forms of supervision.

114. On the one hand, such countries as Hong Kong (since May 1989), Singapore (since 1986), Republic of Korea, Taiwan Province of China, Thailand (since March 1992), Indonesia (since 1990), Turkey (since 1982), India (since 1988), Hungary, Panama (since 1970), follow the *one-agency model* (see table 9 of annex I). The Ministries of Finance and the SECs have complete authority over the formulation and the implementation of securities market policies. In certain countries, such as Barbados and Trinidad and Tobago, the creation of securities supervisory bodies is currently being considered.

115. On the other hand, Malaysia and, to a lesser extent, Mexico and Brazil 39/ have applied *fragmented forms of supervision* (see table 9 of annex I).

116. Fragmentation of authority, as evidenced in Malaysia, Mexico and Brazil, can prove costly for their stock exchange development. For example, in Malaysia this has prompted a regulatory reform creating a single Securities Commission in March 1993.

4. Capital account liberalization

117. The way Governments regulate inward/outward securities investment (the degree of capital account liberalization) is another important factor for the establishment of regional capital markets. Based on the *IMF Exchange Arrangements and Exchange Restrictions, Annual Report 1992*, table 10 of annex I sums up such regulation in 42 non-OECD countries. In order to present a realistic comparison, table 11 of annex I describes the current Code of Liberalization of Capital Movements as accepted by the OECD member States. These two tables offer a comprehensive overview of measures restricting or allowing inward and outward investment and foreign ownership of domestic equities.

118. In this sense, both developed and developing countries share highly varying degrees of liberalization which are not always connected to the level of development. 40/ In the non-OECD group, a liberal approach

characterizes not only such relatively advanced countries and territories as Hong Kong and Singapore, but also Panama, Jamaica and Tunisia. Restrictive treatment characterizes such cases as the Republic of Korea, Mexico, Morocco, Philippines, Trinidad and Tobago, Chile, Indonesia, Pakistan, Sri Lanka and Nigeria. Another common feature of all markets is the divergence of regulations within the same group (as in the CARICOM) and the scarcity of intra-regional preferences. In developing countries, regional preferences exist within CARICOM, MERCOSUR and, for residents of West African Monetary Union (WAMU) member countries, Côte d'Ivoire.

119. In contrast with OECD member countries, emerging markets are more inclined to restrict the foreign ownership of securities. 41/ Restrictions on foreign ownership do not always have an economic rationale but may remain from previous closed-door policies. They rarely reflect regional preferences. 42/

120. A new element of regulation in the emerging markets is a gradual liberalization welcoming foreign investors. Some relatively restrictive countries such as Republic of Korea, 43/ Taiwan Province of China, 44/ Mexico and Thailand are now in the process of liberalizing and internationalizing their securities markets. In the same vein of liberalization, Mexico and the Philippines introduced United States warrants in their capital markets in 1992. The introduction of American Depository Receipts (ADRs) and International Depository Receipts (IDRs) is currently under review in Thailand. These initiatives will facilitate direct investment in domestic securities by international investors.

IV. PROPOSALS FOR FOSTERING REGIONAL CAPITAL MARKETS

121. Fostering regional capital markets entails both a process of nurturing of domestic markets and regionally harmonized actions aiming at attaining capital market integration. Both processes involve actions at private and public level. Most of these actions fall under the competence of regulators/supervisors or market players. In addition, the business attitudes of enterprises/financial institutions that engage in debt and equity transactions may further influence the development of capital markets.

A. Establishment and/or strengthening of domestic capital markets

122. The proposed regional capital markets are arrangements based on cooperation among the existing and operational domestic securities markets. Therefore, it is advisable to establish domestic markets under the most appropriate form (stock exchange, parallel market or OTC market) where it is economically rational and feasible. In countries where securities markets already exist, they need to be strengthened in order to be able to cooperate regionally in the most efficient way then, later on, compete successfully in global markets.

123. Some countries may follow the Mexican example regarding preparation for internationalization of stock markets. In Mexico, a second-tier domestic market was created for small- and medium-sized domestic companies while the big companies of the first tier are increasingly owned by foreign investors. A similar strategy may become necessary also in the BEIA project where regional trading can start in relatively big companies, leaving the small enterprises to local trading.

124. The establishment and/or strengthening of domestic capital markets imply various actions at both private and public level. These actions (summarized in box 7) as a general rule should be implemented simultaneously. Nevertheless, a certain sequential order may be envisaged for actions at the private level.

Box 7

Basic requisites for strengthening and/or establishing domestic capital markets

At the private level:

1. Adaptation of the institutional framework

2. Technological progress

3. Adequate custody, settlement and clearing system

At public levels:

4. Stable political-economic environment

5. Adjustment of the legislative and regulatory context (supervision, taxation, etc) and adoption of international standards

6. Policies increasing the supply of shares (private pension funds, privatization)

1. Actions at the private level

125. At the private level, a first step would entail an adequate institutional framework, i.e. an effective system of intermediaries including brokers, dealers and underwriters. These activities may be performed initially by banks but should become independent as soon as financially viable. Furthermore, the institutional framework entails adequate communication facilities, and an institutional system for transmitting information relating to price, market and companies. It would also require effective financial institutions and channels for the marketing of securities and a corps of practising corporate lawyers, audit firms and reporting accountants.

126. The process of capital market development would also require a framework for the creation of an institutional investor market, including the development of insurance companies, unit trusts and provident funds. These largest investors play an important role in the nurturing of securities markets.

127. A second type of action relates to technological progress on the level of individual stock exchanges, implying the automation of trading and settlement, backed by the services of a modern telecommunications company.

128. A third type of action involves the establishment of adequate custody, settlement and clearing systems. This process is closely linked to automation. In the case of custody, the minimum requirement is the creation of a custody centre where securities are kept and ownership certificates are issued without the risk of being counterfeited. While in closed and small domestic systems, trading may imply the effective transfer of securities in their physical entity, this is no longer possible in growing and internationalizing markets where the costs of physical handling of original securities papers would be unbearable.

129. Additionally, the strengthening of domestic stock exchanges may imply permanent communication and eventually, improved institutional links with commodity exchanges in fields of common interest (i.e. futures market, foreign exchange market, etc.).

2. Actions at the public level

130. At the public level, policy-makers may create a favourable environment for capital market activities, such as: **(a)** the creation of a stable political and economic environment which implies the integration of the private sector and the capital market into the country's overall development programme, particularly in the execution of privatization programmes; **(b)** the creation of an adequate tax, legislative, regulatory and supervisory framework, particularly by setting up basic standards and rules on the avoidance of fraud, and **(c)** policies that favour the supply of equities such as the establishment of private provident funds or the conduit of a privatization strategy which channels available shares through the stock exchange, and, the tendency to channel public debt instruments through capital markets. These aspects are summarized in box 7 above.

3. Adequate balance between regulation and deregulation

131. Capital market development calls for a balance between the freedom needed to stimulate competition and growth and the control needed to prevent fraud and instability. 45/ The practical implementation of this principle shows great diversity.

132. In the case of the European Union, for example, the desire to strengthen the region's capital markets has resulted in a discussion about the mutually offsetting goals of transparency or liquidity. The proponents of stricter controls advocate the principle of transparency to justify their point of view while the supporters of liberalization emphasize the need for greater liquidity.

133. In some developed countries, market-based financial discipline may prove to be more or less sufficient. But it is hard to imagine any emerging country that could rely only on self-discipline in the regulation of capital markets. In general, the problems are: asymmetries of international systems, and the risk of collapse of the financial system.

134. Beside these elements that generally justify supervision and regulation, relatively less advanced countries have non-economic reasons, too, to emphasize the importance of government regulations. Whereas in developed countries, stock exchanges began as private responses to economic needs, in many developing countries, Governments participated in their creation with fixed goals in mind.

4. Improvement of the legal, regulatory and tax environment

135. In developing countries, the improvement of the legal, regulatory and tax framework, adopting international standards where possible, is one of the preconditions for successful regional capital markets. In practical terms it would require that the following conditions be met:

(a) *Clear legislation/basic law* on the scope of government supervisory activities (preferably concentrating on the primary issues) and for securities market self-regulation (basically in secondary trading) and adequate rules and regulations for brokers, underwriters and other operators of the stock markets;

(b) With respect to the *status of the stock exchange*, as it is mainly a private-sector activity carried out by investors, issuers and securities professionals, it should be established as a private non-profit company with shares owned by members and ruled by a single regulatory authority such as the securities and exchange commission and it should initially have a single market structure with no over-the-counter trading. That can be introduced as the market matures;

(c) Government legislation may create *guidelines for*:

(i) *the regulation of membership* in the stock exchange, such as registration procedures, rules of eligibility of different economic agents, minimum capital requirements, record keeping and reporting standards; and

(ii) *the regulation of the availability of information on listed companies*, such as mandatory regular and occasional disclosures based on generally accepted accounting principles. This can serve as a means of protecting investors from fraud and ensuring efficient pricing in primary and secondary markets. (When a public offer is made, the issuer must generally file a prospectus with the relevant supervisory or listing authority, or both, detailing its financial history and prospects. In addition, a public offer generally entails a continuing obligation to make periodic financial disclosures.);

(d) *Legal and financial measures* and provisions that favour the creation of private capital sources and their being channelled through the official securities market (like private provident funds, privatization funds, etc.);

(e) *legislation on* provisions for a broad range of *securities instruments* (gilts, corporate bonds and equities) of varying terms, return and risk;

(f) A *general policy effort* to encourage savers to invest, particularly in equities and to enlighten the public about the relevance and benefits of a stock exchange;

(g) the *appropriate incentives* such as lower corporate tax, dividend exemption benefits and other tax incentives must also be harmonized within groupings.

B. Regionally harmonized actions required for an adequate framework of regional capital markets

136. The process of integration of capital markets entails the opening of markets to foreign investments and adapting them to the requirements of the integration process and of the competitive climate resulting from regional capital markets. Domestic institutions need to introduce some changes such as improved technology, communication links and services. In addition, regional institutions should embrace a broad concept of integration including the administrative, institutional, legal, fiscal and regulatory aspects of capital markets.

137. Two alternatives may be envisaged to formulate proposals for fostering regional capital markets. One consists of analysing the lessons learned from the selected cases of emerging capital markets in Asian, African and Latin American countries, and the experience of domestic integration of capital markets in developing countries that have several domestic stock exchanges (e.g. India, Brazil and Nigeria). Another approach is to try to

extract useful elements from the already existing schemes (the Caribbean Stock Exchange, the BEIA Project, BOLCEN) discussed in chapter III above.

138. As deduced from both approaches, certain steps may foster successful regional capital market cooperation. Harmonization should be carried out in a way which respects the autonomy of domestic markets and their regulators. Under this framework, harmonization should be viewed as a necessary minimum which eliminates incompatibilities among markets. These steps are discussed below:

1. *Actions at the private level*

(a) The establishment of regular *channels of exchange of information exchange* among securities markets

139. The creation and/or strengthening of regular channels of information exchange among securities markets implies either formal agreements on information flows or the establishment of forums for regular discussions. In the latter case, the dialogue may involve other actors, particularly supervisory agencies. The above-mentioned forums may work most efficiently when structured as regional federations/associations, following the examples of FIABV, BOLCEN, ASEA, the Union of Arab Stock Exchanges and the East Asian and Oceanian Stock Exchanges Federation which cover the developing world and the Federation of Stock Exchanges in the European Community which now covers the whole European Economic Area (EEA). These organizations have adopted target-oriented agendas.

(b) The *harmonization of technology* in use with the final aim of creating an interconnected regional electronic trading and settlement system of up-to-date vintage

140. Harmonization of innovations and upgrading in telecommunications and computer technologies on a regional scale is an important precondition for a regional stock exchange. A modernized and uniform system of electronic interconnection of stock exchanges facilitates the cross-border transfer of funds, as well as cross-border trading and settlement. At present, the stock exchanges of the same region usually show great diversity both from the point of view in terms of level of automation and of the systems applied. The final aim of this exercise is an interconnected regional electronic trading and settlement system among interested stock exchanges, more or less following the example of the BEIA project.

(c) The creation of *links among security trading processes* in different countries

141. The links among securities trading processes in different countries may take various forms. The most common version, applied also in such examples as trading between Argentina and Brazil and within CARICOM, is a correspondent relationship between the brokers in each country involved in the transaction.

142. Another important step towards the linking of domestic exchanges within the same region involves the listing of one country's enterprises on the stock exchanges of other countries and/or in the intra-regional electronic trading system. Such an arrangement may lead also to parallel listings, a phenomenon

quite common in Europe. It means that, on condition that the necessary regulation is harmonized, the same company (with preferably regional business activities) is authorized to list its shares on more than one country's stock exchange at the same time. If countries mutually agree to introduce bilaterally balanced cross-border listings they can form a scheme of cross-listings.

(d) Establishment of a *communications network*

143. The linking of trading processes implies the establishment of a communications network and eventual cooperation schemes among all the interested domestic actors. The custody, settlement and clearing institutions should establish, among themselves, all the necessary channels for settling the balances and transferring the ownership certificates. The settlement mechanism naturally entails the participation of central banks. The listed companies and the interested potential investors may communicate, respectively, via their chambers of commerce and their associations. Finally, telecommunications companies should reach an agreement on the future compatibility of their systems.

(e) The creation of *regional instruments*, i.e. warrants, depositary receipts, and "regional country funds", etc.

144. Beside the linking of trading processes, it is also useful to create such regional instruments as warrants and depositary receipts which might be attractive for risk-avoiding investors both intra- and extra-regional. Among the "instruments", there should be a particular focus on projects envisaging *regional "country funds"*, with a large basket of enterprises from both countries with wide experience in the field as well as new ones. This can solve the problem of information exchange and protect small investors.

145. *"Country funds"* are the best instruments for separating country risk from company risk. There are two reasons for this: (i) investors can choose the most attractive and best-performing enterprises of the countries of the region, and, (ii) *"country funds"* pool risks associated with individual companies, i.e. the good performance (high yield) of certain companies in a fund's basket may compensate for any failure of others. These funds may sometimes be floated on international financial centres but there may also be locally traded ones at the disposal of extra-regional investors who have little experience in intra-regional individual enterprises.

146. The creation of *"country funds"* is an issue promoted jointly by private actors (stock exchanges, interested companies) and public regulators who may participate in setting criteria and actual selection. It can also, like in Argentina and India, be endowed with special treatment in tax, capital repatriation and other special provisions.

2. Actions at the public level

(a) The adoption of *regional capital account convertibility*

147. Although it may be optional, regional capital account convertibility of national currencies will make a programme of monetary cooperation and a potential *regional capital market* really efficient. If capital account

convertibility is implemented within a grouping, it should be accompanied by the creation of efficient cooperation schemes among concerned central banks. If capital flows go intraregional, also their monitoring should go intraregional. This monitoring is even more necessary if, because of the lack of central bodies in participant countries, cross-border clearing and settlement is executed between different commercial banks.

148. Such regional cooperation may concentrate on both the registering of flows and on concerted interventions if necessary. For the purpose of the first, statistical reporting should be reinforced in each country. For the purpose of the latter, central banks should agree on the circumstances under which intervention becomes necessary and on the modalities of such actions.

149. Regional capital account convertibility does not necessarily imply capital account convertibility towards the world ("global convertibility"). Developing regions are not always in the position to open up to global flows. Their desire for protection in this case is also in line with recent developments in the regulation of advanced markets where arguments in favour of partial re-regulation are strong.

(b) The establishment of *regional clearing and settlement arrangements linked to capital transactions;*

150. In the clearing and settlement of securities trading, the links to be created among domestic private securities clearing agents should be supplemented by a regional settlement scheme which involves central monetary authorities in the process. These authorities may follow intra-grouping securities transactions and adopt corrective measures to maintain liquidity if necessary. If these monetary authorities are members of already existing regional clearing houses engaged in the settlement of trade transactions, they can enlarge the mandate of these arrangements to include securities dealing in the eligible transactions. This would imply a multilateral system of balancing capital transactions, preferably under a clearing house window separated from the trade transactions.

151. The mechanism of cross-border clearing will depend on the level of regional capital account convertibility. If it is adopted, clearing and settlement in regional national currencies should be automatic. If not, the countervalue of any cross-border purchase of securities has to be first converted into hard currency. Only then can the transaction be realized. In this case, the decision on whether or not to convert the domestic currency into hard currency will be taken by the central bank of the buyer. In turn, to safeguard himself against this foreign exchange risk, the seller may demand guarantees from the purchaser, making the cross-border transaction time-consuming.

(c) The *regional harmonization of taxation*

152. The regional harmonization of taxation should mean both agreements excluding double taxation within the region and programmes for convergence among national tax systems. The envisaged common tax level may be set in such a way that it would exclude excessive speculation but would not prohibit intraregional securities trading.

(d) The *regional harmonization of regulation, supervision and financial disclosures*

153. The regional harmonization of legislation and supervision should preferably be based on such international standards as the accounting recommendations of the *International Accounting Standards Committee (IASC)*, the Business Conduct Principles and the recommended Capital Adequacy Standards for Securities Firms of the *International Organization of Securities Commissions (IOSCO)*, the Basle Agreement on Capital Adequacy for Financial Institutions (signed under the auspices of the *Bank for International Settlements*) and the Directives of the *European Union*, naturally adapted to local circumstances. (For example, the minimum capital requirement for listing in small developing countries may be lower than in developed markets).

154. IASC, in cooperation with national standard setting bodies and the European Commission, is working on greater compatibility of financial statements across countries through the harmonization of accounting standards. 46/ IASC has issued 31 standards dealing with most of the areas that affect the financial statements of corporations which issue securities in international capital markets. The Committee had aimed, by the end of 1992, to eliminate most of the choices of accounting treatment for similar transactions and events that are currently permitted by *International Accounting Standards*.

155. IOSCO's Business Conduct Principles prescribe the observance of such conduct in securities trading as honesty, fairness, diligence, etc. The *Capital Adequacy Standards for Securities Firms* set a globally acceptable common framework for minimum requirements (see box 8). The Basle Agreement (1987) which resulted in the creation of the consultative body of "Basle Committee", sets standards for all financial firms.

156. In Europe, the *EU Directives* (see box 9) played a key role in facilitating free and fair securities trading. As a consequence of the European Economic Area (EEA) Agreement, investors in any EEA country can purchase securities issued by corporations or by local/central government in any other EEA country. For issuers of securities, the enlargement of the capital market may entail adopting easier and cheaper ways to raise capital, on condition that investors receive reliable information about issuers, that they find these securities sufficiently liquid and that legislation is protective enough to avoid manipulations on the securities markets.

157. The European Union may have a more competitive and rationalized capital market at the turn of the century if all the directives are fully implemented. This process may however face opposition from the present fragmented and protected market actors who fear loss of activities. The example of Europe may be followed by developing countries with some reservation, given the different global economic position of the two.

Box 8

THE IOSCO RECOMMENDATIONS FOR CAPITAL ADEQUACY STANDARDS FOR SECURITIES FIRMS

The report by the International Organization of Securities Commissions (IOSCO) on "Capital Adequacy Standards for Securities Firms", adopted on its 14th Annual Conference (1989), recommended a common conceptual framework regarding the capital requirements for securities firms. The framework contained the following elements:

(a) the coverage of liquidity and solvency needs;

(b) the indication of liquid securities and commodities positions for markets;

(c) the enforcement of risk-based capital requirements.

According to the IOSCO recommendations, the definition of capital should reflect the fluctuating nature of risk-based requirements and the differing regulatory structures of member countries. Minimum capital requirements may differ depending on a firm's type of business but they should not be set so high as to affect adversely competition in the marketplace. These requirements imply adequate record-keeping, reporting, and examination programmes.

In September 1991, IOSCO sent to the Basle Committee a memorandum summarizing its members' positions on establishing common minimum capital standards for internationally active securities firms and banks. IOSCO also proposed for the Basle Committee an agreement on an international standard for position risk requirements and a definition of permitted regulatory capital.

Traditional capital adequacy standards for securities firms used to capture both credit and market risk in a single, comprehensive weight. In contrast, the IOSCO and the Basle Committee agreed on a «building block» approach that separates credit risk from market risk.

IOSCO considered that there should be an internationally agreed minimum capital standard for traded equities. A majority of members agreed that this standard, expressed in terms of the building block methodology, should be 4 per cent for gross positions (both long and short) and 8 per cent for net positions (for diversified portfolios of highly liquid equities), although some countries preferred higher and others lower figures. Regarding the standard's implementation, IOSCO recommended that all securities regulators agree either (a) to adopt minimum thresholds for equities, if using the building-block methodology or (b) if not implementing that methodology, to adopt threshold requirements that, in the aggregate, are no less stringent than those required by the building-block approach.

Box 9

THE EUROPEAN UNION DIRECTIVES ON SECURITIES TRADING TO BE APPLIED IN THE EUROPEAN ECONOMIC AREA (EEA)

(1) Directive 79/279/EEC on minimum requirements for stock exchange listed securities (benchmarks on capitalization of the company, on treatment of shareholders, on publication of information like annual accounts).

(2) Directive 80/390/EEC, amended by Directives 82/148/EEC and 90/211/EEC on information to be published by issuers of securities to be listed on an official stock exchange. The layout is specified in the Annex of Directive 80/390/EEC.

(3) Directive 89/298/EEC on the prospectus and on relevant information about issuers on both the organized markets and the over-the-counter market (main field of activities, its financial situation, its administration and management). The prospectus prepared in one EEA country according to these Directives shall be recognized by all the other EEA members.

(4) Directive 90/211/EEC on the mutual acceptance of prospectuses for admission to other stock exchanges.

(5) Directive 82/121/EEC on the regular publication (at least, every six months) of information with accounting effect, about the financial situation and the activities of the issuer of securities.

(6) Directive 88/627/EEC on reporting of major changes in the composition of ownership of the issuer of securities.

(7) Directive 89/592/EEC prohibiting insider trading.

(8) Directive 85/611/EEC on minimum criteria for licensing Undertakings for Collective Investments in Transferable Securities (trust funds or investment funds) in member countries. A UCITS must have as sole objective to invest in transferable (liquid) securities with the capital it raises from the public. The units sold by a UCITS to the public must be repurchasable and redeemable. The administration and the safekeeping of assets must be entrusted to a depository. Authorization to a UCITS from one EEA country will be recognized by all the other EEA countries.

(e) Monetary and fiscal harmonization

158. The normal flow of cross-border investment within a given grouping depends on a certain level of monetary and fiscal harmonization. The total lack of convergence in such areas as the liberalization of interest rates, central government deficit and, particularly, foreign exchange policy(exchange rate management, regional convertibility), usually accompanied by such symptoms as divergent inflation rates, may result in either one-sided capital flows which may represent an unbearable burden on all partners or, owing to the uncertainty of the zone and the incompatibility of countries, no cross-border trading whatsoever. Countries with diverging monetary performance (particularly the inflation rate) find it difficult even to manage day-to-day routine financial operations.

159. Flourishing regional capital markets may depend also on a minimum convergence in fiscal policies. The coordination of fiscal policies may aim at, *inter alia*, establishing maximum limits to fiscal deficits, the prohibition of their financing with central banks' credits, the establishment of maximum limits to the public debt/GDP ratio. When divergences in these fields are excessive, market participants coming from different countries of the region cannot enjoy equal opportunities. In addition, it is important to harmonize the fiscal and incentives policies given their incidence on the movements of goods, services, capital and factors within a region. This requires a comprehensive process of concertation. The compromise elaborated in this process may eventually imply a commitment to intraregional consultations before adopting national fiscal measures.

160. A minimum level of harmonization does not imply uniformity. The latter is not only impractical but also undesirable. One of the driving forces of cross-border securities movements within any area may be exactly the divergent patterns of savings, equity supply and demand, fiscal deficits.

C. The potential for outside technical assistance programmes

161. While this study is policy-oriented, some of its findings and conclusions may serve as a basis for future technical cooperation activities. Given the need for and the interest in improving domestic capital markets and establishing their regional networks worldwide, there are wide possibilities in this field. For example, the aim of "Fostering regional capital markets in ECOWAS" is under discussion under the ECOWAS Monetary Cooperation Programme. Furthermore, the proposal of the African Capital Markets Forum 47/ is to establish formal capital markets; accelerate the development of existing markets; to promote cooperation and to provide a forum for the exchange of ideas among African capital market institutions. In the case of the Andean Group, 48/ integration of capital markets is considered of primary importance for a more efficient resource allocation and as a source of long-term finance.

162. If, based on this study, a programme of action is formulated, its aims may be transformed into technical cooperation projects. It would be necessary to analyse in depth and in separate papers the cases of individual groupings aiming at the formulation of more concrete and practice-oriented proposals for the improvement of local markets and for the design of their regional cooperation which may be implemented in a short period of time.

163. Instead of projects encompassing all the aspects of capital market cooperation within a region, technical cooperation may also be envisaged in certain priority issues. In this case, assistance may be targeted at solving specific problems such as taxation, harmonization of rules, the modalities of cross-border trading, etc., with the aim of suggesting standard ways to achieve regional harmonization in these fields.

Notes

1/ Since November 1992, the ECDC Division has established contacts with 32 domestic stock exchanges and 4 regional institutions which have described their main activities and supplied relevant information for a database oriented to the possible forms of regional capital markets and the impediments to establishing them. Most of the examples mentioned in this study are derived from this source, i.e. first-hand information. Stock exchanges and relevant regional institutions contacted responded positively to the ECDC Division's request.

2/ For the definition of financial terms, please refer to the glossary in annex II.

3/ The term *emerging* capital markets is used as a synonym for developing and other non-developed (Eastern European, Asian) markets. For details, see Chapter II, section A below.

4/ Non-debt creating flows take the following forms: official bilateral grants, private direct investment, private portfolio investment. The latter two are normally channelled through institutionalized capital markets, either in developed (international) centres or in emerging capital markets.

5/ "... in LDCs which are too small to sustain a viable securities market on their own, creation of regional markets can serve the needs of several small neighbouring countries (currently under discussion in West Africa and the Caribbean ...". Pardy [1992].

6/ Instituto Latinoamericano de Investigaciones Sociales (ILDIS): The Capital Markets in the Process of Andean Integration (Joint project ILDIS/Andean Development Corporation (CAF)).

7/ For details and figures on the volatility of emerging markets, please see **Fédération Internationale de Bourses des Valeurs [1994]**, particularly pp. 22 and 24.

8/ The figure corresponding to year 1993 has been derived from **FIABV [1994]**, p. 21.

9/ See Baring Securities [1992], p. 3.

10/ The National Association of Securities Dealers Automated Quoting (NASDAQ) Stock Market, registered in Atlanta, Georgia, is the biggest over-the-counter electronic trading system of the United States. It trades equities of a diverse group of American industrial companies under the

framework of a multiple market-maker system, based on advanced computer and telecommunications technology. NASDAQ International increases exposure of these companies by allowing the trading of their stocks in the United Kingdom. NASDAQ is regulated by the National Association of Securities Dealers, Inc., its self-regulatory body.

11/ See Baring Securities [1992], p. 5.

12/ Hong Kong and Singapore have become major international centres of capital market activity. Thus they are considered to be part of the developed markets.

13/ Both the developing countries where securities exchanges that had earlier played an important role and the Central and Eastern European countries where stock exchanges re-opened their doors in the 1990s, after many years of suspended activities such as in Warsaw and Budapest, may be called *re-emerging* markets.

14/ Two indicators may illustrate the relative importance of this group of emerging capital markets in the global financial marketplace. According to data for 1992 presented in table 1 of annex I, in terms of *value traded*, Taiwan Province of China is the world's fifth most active market after the United States, Japan, United Kingdom and Germany, and well before France and Switzerland which have trading volumes comparable to that of the Republic of Korea. Mexico, in turn, equals the Netherlands, Australia and Spain, while Thailand compares with Canada and Hong Kong. In terms of *market capitalization*, Mexico leads the *emerging* group, with a level comparable to that of the Netherlands and Australia, followed by the Republic of Korea, Taiwan Province of China and Malaysia which compare with Spain, and are larger markets than Sweden, Belgium, Denmark and the smaller OECD countries.

15/ From a technical viewpoint, as is the case of most *emerging* markets, low levels of development are observed in terms of compensation and settlement for securities, the dissemination of information, as well as the degree of automation attained on the floor. As regards the economic background, in general terms many *emerging* capital markets face cyclical and structural problems such as: high inflation rate, high income concentration, external disequilibria reflected in currency devaluations, and unsatisfactory development of money markets. As far as access to international markets is concerned, it is highly selective for them and thus, the situation varies from one country to another.

16/ See IFC [1992].

17/ Value traded per market capitalization. See also the glossary in annex II.

18/ For the definition of specific financial terms, please refer to the glossary in annex II.

19/ Although not of direct concern for emerging markets, in major financial markets one of the most noticeable developments during the past five years has been the growth in volume and diversity of financial derivative instruments. The major intermediaries or dealers in the derivatives markets tend to be large banks and securities firms. Their growing size is a cause of concern among regulators.

20/ The Stock Exchange Automated Quotation System (SEAQ), a subsidiary of the London Stock Exchange, is a totally automated electronic system of quotation and settlement deals. Its transactions take place five days per week, from 7.30 a.m. to 6 p.m., London time. The participants in the SEAQ system are obliged to act as Market Makers. See Verlag Finanz und Wirtschaft [1992], p.6.

21/ See ASEAN-UNDP [1989], pp. 3-4.

22/ See Germidis et al. [1991], p. 135.

23/ For details, see March Venegas [1992].

24/ See Baring Securities [1993], p. 40.

25/ Decentralized capital market structures mean that the same country has more than one separate stock exchange. This implies that either the same companies are listed in different stock exchanges at the same time or that the same stock exchanges compete for the same clients. Consequently, the capital market activity of the country remains fragmented.

26/ Ahmedabad, Bangalore, Bhubaneshwar, Bombay, Calcutta, Cochin, Coimbatore, Delhi, Guwahati, Hyderabad, Indore, Jaipur, Kanpur, Ludhiana, Madras, Magadh, Mangalore, Pune, Saurashtra, Vadodara.

27/ Bahia-Sergipe-Alagoas (Salvador), Extremo Sul (Porto Alegre), Minas-Espírito Santo-Brasília (Belo Horizonte), Paraná (Curitiba), Pernambuco e Paraíba (Recife), Regional (Fortaleza), Rio de Janeiro, Santos, São Paulo (BOVESPA).

28/ Capital account convertibility refers to the free exchange of receipts originating from capital transactions of foreign to domestic currency for residents and, the free repatriation of non-resident's income originating from capital transactions.

29/ This was the case of the Cooperation Council for the Arab States of the Gulf (GCC) where the Bahrain Stock Exchange, backed by government legislation, unilaterally authorized trading in intra-grouping companies. In the case of the Kuwait Stock Exchange, dealing has been licensed both in cross-border listing and trading in GCC enterprises. As a result, in Kuwait, as of 31 December 1992, six of the 39 companies listed on the Stock Exchange were registered in other GCC countries. In Bahrain, a committee investigates the possibilities of listing corporations incorporated in the Kuwait Stock Exchange.

30/ Barbados, Jamaica and Trinidad and Tobago.

31/ LATINET is a subsidiary of Consultoria, Métodos, Assessoria e Mercantil Ltda, headquartered in Rio de Janeiro, Brazil.

32/ The only remaining restrictions to these transactions are the following: (a) securities must be registered in the name of the seller and ownership certificates stamped by the register office in Bahrain; (b) securities must not be held or withheld as collaterals, and (c) payment must be made in cash or by cheque payable to a commercial bank in Bahrain.

See Bahrain Stock Exchange [no date], pp. 29-30.

33/ As of June 1993, the membership of the Andean Group and of the LARF is identical: Bolivia, Colombia, Ecuador, Peru, Venezuela.

34/ See Pardy [1992], p. 20.

35/ The current Hong Kong system relies on physical settlement of individual trades. No part of the process is centralized or automated, and there is no netting of trades between brokers before settlement. At present, Hong Kong is a market that relies on one-sided matching as opposed to the international standard of two-sided matching. In Indonesia and in Ghana, as further examples, settlement is hand-operated.

36/ Chuppe - Atkin [1992], p. 5

37/ In this regard, negotiations are carried out by the Basle Committee on Banking Supervision and the Technical Committee of the International Organization of Securities Commissions (IOSCO) to examine proposed minimum capital standards covering the securities activities of internationally active banks and securities firms. This subject is discussed further in chapter IV, section B.

38/ In terms of *dividend taxes*, zero rate is applied in Hong Kong, Malaysia, Singapore, Turkey and Tunisia. In contrast, 35 per cent is levied in the Philippines, 40 per cent on legal entities and 10 per cent on individuals in Hungary, 30 per cent on residents and zero on non-residents in Cyprus, 20 to 35 per cent in Taiwan Province of China and 15 to 25 per cent in Brazil. Incomes from *interest* are not taxed in Brazil, Panama and Tunisia while they are taxed heavily in Peru (37 per cent) and in Singapore (33 per cent). Among the countries with differentiated interest tax levels, the tax burden can reach 40 per cent in Hungary, 30 per cent in Ghana and 25 per cent in the Republic of Korea. Finally, in terms of *capital gain taxes*, the most favourable treatment (zero per cent) is offered by Cyprus, Hong Kong, Indonesia, Malaysia, Panama, Poland, Singapore, Taiwan Province of China, Tunisia, Ghana (if the company is listed on the stock exchange) and Turkey (if the security is purchased through the stock exchange). In contrast, capital gains are taxed at 37 per cent in Peru, 20 to 40 per cent in Hungary and 30 per cent in Zimbabwe.

39/ In Brazil, general regulation is confined to the National Monetary Council, while supervision is shared by the Central Bank and the Securities Commission (CVM).

40/ In the OECD, 11 of the 23 member countries, including the United Kingdom, Japan, Canada, Sweden, Italy, Ireland and New Zealand have highly liberal systems. In contrast, several restrictions are observed in Greece, Portugal, Turkey, Spain and Austria. The rest (seven countries) including the United States, Germany and France, are moderately restrictive on capital movements.

41/ General limits are applied by India (51 per cent), and Indonesia (49 per cent). Varying degrees are preferred by Thailand (25 to 50 per cent), Cyprus (5 to 49 per cent), Malaysia (up to 80 per cent) and Mexico (although exemptions are widely granted). The Republic of Korea and Taiwan Province of China apply strongly restrictive systems.

42/ One of the few cases to be mentioned is Kuwait where the general limit is 49 per cent but GCC nationals are exempted up to 75 per cent.

43/ As part of the efforts to internationalize its securities market, the Government of the Republic of Korea plans to allow foreign securities firms to set up branch offices and form joint ventures with domestic companies. Foreigners were permitted to invest directly in securities in 1992.

44/ Recently, Taiwan Province of China's authorities permitted foreign institutional investors, including banks, insurance companies, and fund management firms to invest directly, within limits, in the securities listed on the Taiwan Stock Exchange. Moreover, revision of the Securities and Exchange Law is under way to allow local securities firms to act as agents to buy and sell foreign securities, to establish overseas branches, or to become members of foreign stock exchanges.

45/ World Bank [1989], p. 53.

46/ The International Accounting Standards Committee (1991) discusses efforts to improve the comparability of financial statements across countries.

47/ See Economic Commission for Africa (ECA): Report of the Steering Committee on the Formation of African Capital Market Forum. Meeting of the Intergovernmental Group of Experts of the Vth Session of the Conference of African Ministers of Finance. (Addis Ababa, Ethiopia, December 1993) (E/ECA/PHSD/PAM/93/9, Libreville, Gabon, 21-23 February 1994).

48/ Instituto Latinoamericano de Investigaciones Sociales (ILDIS): La integración de los mercados de capitales en el Grupo Andino. On-going research with the support of the Andean Development Corporation (CAF), Caracas, Venezuela, 1993.

Annex I

Table 1

Overview of emerging capital markets (as compared with other regions), 1990-1992

	Number of listed companies			Market Capitalization (market value of shares) (Billions of US $)			Market trading value in shares (Billions of US $)		
	1990	1991	1992	1990	1991	1992	1990	1991	1992
TOTAL OF EMERGING MARKETS	12'200	12'638	13'312	507.10	729.77	837.34	886.70	624.24	605.02
LATIN AMERICA	1'810	1'810	1'874	101.05	255.81	296.91	22.69	82.02	96.53
of which:									
Mexico	199	207	199	41.05	102.76	138.74	12.17	39.55	51.40
Brazil (São Paulo and Rio de Janeiro)	512	598	590	30.24	87.69	90.68	5.84	11.77	23.06
Chile	216	223	244	13.64	27.99	29.60	0.76	1.88	2.06
Argentina (Buenos Aires)	179	169	170	3.62	18.64	18.62	0.78	4.58	15.85
Venezuela	57	60	62	8.36	11.21	7.60	2.23	3.24	2.63
Colombia	80	83	80	1.42	4.04	5.68	0.07	0.20	0.55
Peru	265	273	287	0.81	1.12	1.44 e/	0.59	0.58	0.54 e/
Jamaica	44	44	48	0.91	1.03	3.23	0.03	0.05	0.39
Trinidad and Tobago	30	29	32	0.70	0.87	0.52 c/	0.18	0.14	0.02
Costa Rica	78 a/	82	79		0.31	0.48	0.00	0.00	0.00 d/
Barbados	14	14	15	0.28	0.31	0.28 c/	0.01	0.01	0.00
Uruguay	36	28	26	0.02 a/	0.04	0.04	0.00 a/	0.00	0.01
SOUTH AND EAST ASIA	8'869	9'241	9'727	342.36	421.97	489.80	849.82	547.37	492.46
of which:									
Taiwan Province of China	205	221	256	96.93	123.46	100.17	711.74	386.03	250.33
Republic of Korea	577	686	688	110.30	96.47	107.66	75.63	85.09	116.07
Thailand (including OTC)	214	270	315	28.63	37.53	57.28	24.78	31.18	72.23
Malaysia (including OTC)	282	321	368	47.87	56.72	91.47	10.73	10.57	19.73
India (Bombay)	6'430	6'500	6'700	38.57	47.73	65.12	21.92	24.30	20.60
Islamic Rep. of Iran		97	118		30.92	29.66		5.66	7.43
Indonesia	123	139	153	8.08	8.23	12.12	3.99	2.98	3.91
Philippines (including OTC)	153	161	168	5.93	11.17	16.80 e/	0.75	0.83	1.06 e/
Pakistan	487	542	628	2.82	7.58	7.69	0.23	0.62	0.98
Sri Lanka	164	166	190 b/	0.92	1.90	1.53 b/	0.04	0.10	0.11 b/
Bangladesh	134	138	145	0.32	0.27	0.31	0.01	0.00	0.01
China (Shenzhen)		6	33			8.50			7.35
MIDDLE EAST	924	944	1'015	34.05	22.69	26.65	8.42	9.27	10.64
of which:									
Turkey (including OTC)	110	134	145	18.85	15.51	9.76	5.87	8.28	8.35
Jordan (including OTC)	105	101	103	1.93	2.50	3.30	0.41	0.45	1.32
Kuwait	52 a/	0	33 b/	9.93 a/	0.00	9.12	1.71 a/	0.00	0.40 b/
Egypt (Cairo)	573	627	656	1.84	2.53	2.59	0.13	0.26	0.29
Morocco	71	67	62	0.97	1.53	1.88	0.06	0.05	0.07
Tunisia	13	15	16 d/	0.53	0.63		0.08	0.10	0.08 e/
SUB-SAHARAN AFRICA	265	292	322	5.11	4.63	2.97	0.08	0.11	0.06
of which:									
Nigeria	131	142	153	1.37	1.88	1.24	0.01	0.01	0.02
Zimbabwe	57	60	62	2.68	1.41	0.65	0.05	0.08	0.02
Kenya	54	53	57	0.45	0.64	0.39	0.01	0.01	0.01
Côte d'Ivoire	23	23	24	0.37	0.37	0.35	0.00	0.01	0.00
Ghana		14	15		0.08	0.09		0.00	0.00
EUROPE	332	351	374	24.53	24.67	21.01	5.71	5.48	5.32
of which:									
Portugal	181	180	191	9.20	9.61	9.21	1.69	2.82	3.46
Greece	145	126	129	15.23	13.12	9.49	3.92	2.44	1.61
Cyprus (OTC)		16	15		1.29	1.31		0.02	0.02
Hungary	6	20	23	0.10	0.51	0.79	0.10	0.17	0.08
Poland		9	16		0.14	0.22		0.03	0.16
DEVELOPED MARKETS	18'421	19'877	19'032	8'965.66	10'624.37	10'095.89	4'951.36	4'818.29	5'161.34
of which:									
Japan	1'749	1'764	1'768	2'917.68	3'117.53	2'397.37	1'531.52	961.52	597.91
United States	6'599	6'742	5'762	3'089.65	4'099.48	4'497.83	1'815.48	2'329.44	2'763.16
United Kingdom	2'309	2'572	2'440	850.01	986.11	928.39	543.39	553.92	662.99
Germany	647	1'243	1'259	355.31	392.47	346.89	508.71	404.65	454.21
France	669	839	1'008	311.69	373.36	349.61	121.06	116.65	124.88
Canada	1'193	1'138	1'119	241.92	265.70	241.88	71.44	78.17	83.10
Switzerland	399	424	420	157.63	173.77	189.12	56.59	83.08	116.53
Netherlands	283	412	413	119.83	135.98	134.19	40.82	38.92	45.73
Italy	220	267	258	148.77	158.81	128.97	42.17	23.45	27.25
Australia	1'084	1'005	1'073	107.94	142.40	133.56	40.19	46.70	45.58
Spain	429	433	401	111.45	127.30	98.85	42.77	45.13	42.31
Hong Kong	239	357	413	83.39	121.88	171.98	34.68	38.80	78.64
Sweden	132	127	118	92.01	97.06	76.17	15.74	20.57	27.73
South Africa	759	728	671	136.87	167.96	148.68	10.47	8.70	8.50
Singapore	159	182	195	34.27	47.59	48.93	21.07	18.06	18.91

a/ 1989
b/ January to April 1993
c/ January to June 1992
d/ January to September 1992
e/ January to October 1992
f/ January to November 1992
Source: UNCTAD, based on FIBV (1992b), IFC (1992), and national reports

Table 2
Indicators of selected emerging capital markets as compared with selected developed markets

Name of market	Indicators: Market capitalization per GDP 1991	Year	New capital raised by domestic companies per market capitalization	Number of biggest companies	Biggest companies' share in value traded	Biggest companies' share in market capitalization	Turnover velocity of domestic shares (Value traded per market capitalization)	Price per earnings ratio (PER)	Foreigners' transactions per value traded	Turnover value of bonds traded per value traded in shares (relative importance of bond market)
Emerging markets:										
Taiwan Prov. of China	n.a.	1992	4.69%	13	22.90%	33.30%	235.30%	22.90	n.a.	0.06%
Malaysia (including OTC)	113.32%	1992	3.96%	18	21.80%	51.80%	20.90%	22.80	n.a.	1.68%
Chile	95.90%	1992	1.62%	12	63.80%	57.70%	6.90%	14.30	n.a.	654.62% b/
Jordan	60.09%	1992	0.72%	n.a.	n.a.	n.a.	40.06%	14.74	n.a.	n.a.
Jamaica	52.43%	1991	1.15%	n.a.	n.a.	n.a.	5.21%	n.a.	n.a.	n.a.
Brazil (S.Paulo and Rio)	46.06%	1992	0.51%	27	83.70%	62.30%	25.45%	8.05	6.67% c/	n.a.
Mexico	40.67%	1992	3.50%	5	28.90%	32.50%	32.70%	13.50	21.12% c/	482.32%
Rep. of Korea	35.37%	1992	2.12%	34	38.60%	52.80%	107.80%	10.80	n.a.	0.67%
Thailand (including OTC)	35.30% a/	1992	3.75%	16	46.80%	42.80%	125.50%	16.30	8.21%	0.01%
Philippines (Manila)	23.93%	1992	n.a.	20	68.12% e/	n.a.	6.33%	n.a.	n.a.	n.a.
Sri Lanka	21.60%	1991	1.11%	20	70.27%	37.38% f/	5.46%	20.00	40.99%	n.a.
Cyprus OTC	21.37%	1992	9.00%	15	100.00%	80.73% f/	2.22%	20.00	n.a.	n.a.
Turkey (incl. OTC)	19.51% a/	1992	12.08%	7	40.30%	36.20%	85.60%	11.40	n.a.	31.86%
Argentina	14.77% a/	1992	1.67%	9	62.50%	68.50%	85.10%	40.40	n.a.	8.56%
Indonesia	7.22%	1992	0.50%	20	79.45%	40.02% f/	32.29%	15.65	24.05%	0.28%
Costa Rica	6.24%	1991	1.25%	n.a.	n.a.	n.a.	1.23%	n.a.	n.a.	n.a.
Tunisia	4.47%	1991	n.a.	15	100.00%	100.00%	15.37%	n.a.	n.a.	1.53%
Peru	3.15%	1991	n.a.	n.a.	n.a.	n.a.	51.61%	n.a.	n.a.	2.56%
Hungary	1.66%	1991	n.a.	20	100.00%	100.00%	33.64%	n.a.	n.a.	460.22% d/
Ghana	1.54%	1992	n.a.	15	100.00%	100.00%	0.46%	n.a.	50.00% c/	n.a.
Côte d'Ivoire	n.a.	1992	7.13%	n.a.	n.a.	n.a.	1.28%	n.a.	n.a.	13.09%
AVERAGE	31.82%		3.42%	17	64.20%	59.74%	43.83%	17.76	-	127.50%
Developed markets:										
Singapore (incl. OTC)	112.44%	1992	1.42% b/	9	14.60%	45.20%	38.60%	19.50	-	4.89%
United States	64.67%	1992	1.91%	n.a.	n.a.	n.a.	42.90%	22.70	-	0.67%
United Kingdom	94.06%	1992	1.16%	115	43.30%	76.30%	40.50%	17.50	-	173.72%
Japan	86.95%	1992	0.13%	83	42.10%	48.40%	19.80%	36.70	-	24.53%

a/ 1990
b/ 1991
c/ foreigners' ownership position per market capitalization
d/ 1992
e/ January to September 1992
f/ 10 biggest companies

Source: UNCTAD estimates, based on FIBV Statistics 1992 and reports by stockmarkets concerned

Table 3

Cross-border trading among the stock exchanges of the Caribbean

(April 1991 to April 1992)

Stock Exchange of operation:		Barbados					Jamaica					Trinidad and Tobago				
		Buy	Sell	Net balance		N° of trans-actions	Buy	Sell	Net balance		N° of trans-actions	Buy	Sell	Net balance		N° of trans-actions
Country of investor:	Period:	(US$)	(US$)	(US$)	as % of value traded		(US$)	(US $)	(US$)	as % of value traded		(US$)	(US$)	(US$)	as % of value traded	
Barbados	April to December 1991	-	-	-	-	-	-	-	-	-	-	2,402,142	6,089	2,396,053	n.a.	372
	January to April 1992	-	-	-	-	-	-	-	-	-	-	-	134,903	2,261,150	n.a.	13
Jamaica	April to December 1991	1,492	-	1,492	n.a.	n.a.	-	-	-	-	-	5,414,964	1,499,979	3,914,985	n.a.	1,124
	January to April 1992	-	-	1,492	n.a.	0	-	-	-	-	-	460,245	899,061	3,476,169	n.a.	189
Trinidad & Tobago	April to December 1991	3,971,117	33,786	3,937,331	n.a.	30	3,182	550	2,633	3.23%	37	-	-	-	-	-
	January to April 1992	-	5,937	3,931,394	n.a.	1	39,484	-	42,116	n.a.	9	-	-	-	-	-

Source: Jamaica Stock Exchange

Table 4

Basic indicators of the stock exchanges of CARICOM in 1992

STOCK EXCHANGE		BARBADOS	JAMAICA	TRINIDAD AND TOBAGO
Year operations started		1987	1969	1981
Number of listed shares		18	52	32
Estimated market capitalization in US$ million, end-June 1992		280	1,048	523
Market capitalization as per cent of estimated GDP, June 1992		16.6	30.0	10.6
Market capitalization as per cent of estimated capitalization in:	Mexico	0.2	0.8	0.4
	Brazil (Rio de Janeiro plus São Paulo)	0.3	1.0	0.5
	Argentina	1.1	4.1	2.0
	Peru	22.8	85.3	42.6

Source: The Stock Exchanges indicated.

Table 5

Bilateral Technical Cooperation and Information Exchange Agreement signed in the framework of the BEIA project (up to June 1993)

	BA	BO	BU	CA	LI	MA	ME	MO	RI	SN	SP
BA	-		yes		yes		yes	yes	yes		
BO		-			yes		yes		yes		
BU	yes		-						yes	yes	yes
CA				-	yes		yes				
LI	yes	yes		yes	-					yes	
MA						-	yes				
ME	yes	yes		yes		yes	-		yes	yes	yes
MO	yes							-	yes		yes
RI	yes	yes	yes				yes	yes	-	yes	
SN			yes		yes		yes		yes	-	yes
SP			yes				yes	yes		yes	-

Abbreviations: BA Barcelona, BO Bogotá, BU Buenos Aires, CA Caracas, LI Lima, MA Madrid, ME Mexico, MO Montevideo, RI Rio de Janeiro, SN Santiago de Chile, SP São Paulo)

Table 6

Examples of central depositary and settlement bodies in selected developing and eastern European countries (at the end of 1992)

Securities market	Central depositary body	Central clearing and settlement body
Buenos Aires	**Caja de Valores S.A.**	
Rio de Janeiro and SENN	Câmara de Liquidação e Custódia S.A. (CLC), independent body, its depositary system interfaces with Calispa in São Paulo	
São Paulo	São Paulo Stock Exchange Clearing House (**Calispa**), its depositary system interfaces with CLC in Rio de Janeiro	
Budapest	no	**Clearing and Depositary Centre** (CDC), owned by the Budapest Stock Exchange, since 1991
Seoul	**Korea Securities Settlement Corporation** (KSSC), wholly owned subsidiary of the Korea Stock Exchange, since 1974 dematerialization for deposit permitted on a limited basis	
Kuala Lumpur	**Malaysian Central Depositary Sdn. Bhd.** (MCD), full-fledged central depositary since 1991	**Securities Clearing Automated Network Services Sdn. Berhad** (SCANS), wholly owned subsidiary of Kuala Lumpur Stock Exchange
Singapore	**Central Depositary Pte Ltd.** (CDP)	**Securities Clearing and Computer Services (Pte) Ltd.** (SCCS) for script-based transactions; CDP for book-based transactions
Colombo	**Central Depositary System (Pvt) Ltd.** (CDS), owned by Colombo Stock Exchange, since June 1992	
Bangkok	**Share Depositary Centre** (SDC) since 1988	**Stock Exchange of Thailand** for script-based transactions; SDC for book-based transactions
Taipei	**Taiwan Securities Central Depositary Co., Ltd.** (TSCD), owned by Taiwan Stock Exchange	
Warsaw	**National Depositary of Securities**	no

Source: UNCTAD, based on reports by the stock exchanges concerned.

Table 7

Indicative tax levels in selected developing and eastern European countries (at the end of 1992)

Country	Dividend	Interest	Capital Gain
Brazil	for physical persons and for investment funds in debt-conversion, privatization, venture capital: 25 other: 15	0	for physical persons and for investment funds in debt-conversion, privatization, venture capital: 25 other: 0
Cyprus	for foreign corporations: 0 others: 30	n.a.	0
Ghana	10	for corporations: 30 for individuals: 0	on stock-exchange listed securities: 0 other: 35
Hong Kong	0	for financial institutions: 0 for others: 16.5	0
Hungary	for legal entities: 40 for individuals: 10	for legal entities: 40 for individuals: 20 on bank interest: 0	for legal entities: 40 for individuals: 20
India	25	25	10 to 30
Indonesia	10 to 15	20	0
Rep. of Korea	public corp.: 10 for others: 25	on bank interest: 10 others: 25	taxable if not exempted by treaty
Malaysia	0	20	0
Panama	10	0	0
Peru	10	37	37
Philippines	35	20	0.25
Poland	20	n.a.	0
Singapore	0	33	0
Taiwan Prov. of China	through approved banks: 20 others: 35	through approved banks: 0 others: 20	0
Thailand	10	for investment funds registered in Thailand: 0 for others: 15	if not exempted by treaty, for institutional investors: 15
Tunisia	0	0	0
Turkey	0	on government securities: 0 on others: 10.5	on securities purchased on the stock exchange: 0 others: 10.5
Zimbabwe	20	n.a.	30

Source: UNCTAD, based on national reports.

Table 8

Examples of basic securities laws in selected developing and eastern European countries (at the end of 1992)

Country	Basic securities trading law
India	Securities Contracts (Regulation) Act of 1956
Nigeria	The Lagos Stock Exchange Act of 6 June 1961
Brazil	Capital Markets Law of 1964
Ghana	Stock Exchange Act (Act 384) of 1971, Securities Industry Law under preparation
Mexico	Securities Market Act of 1975
Bahrain	Legislative Decree N° 4 of 1987
Panama	Decree N° 44 of 1988, revised by Decree N° 37 of 1992
Tunisia	Law N° 89-49 of 8 March 1989
Hungary	Law VI of 25 January 1990 on the Public Offering of Securities and on the Stock Exchange
Poland	Act on Public Trading and Trust Funds of 22 March 1991 and Act on the Warsaw Stock Exchange of 12 April 1991
Thailand	Securities and Exchange Act of 16 March 1992
Turkey	Capital Market Law of 13 May 1992

Source: National stock exchanges.

Table 9

Examples of single- and multiple-agency formats of supervisory agencies in selected developing and eastern European countries (at the end of 1992)

Country	Supervisory agency(ies)
Single-agency format	
Hong Kong	Securities and Futures Commission since May 1989
Singapore	Monetary Authority of Singapore since 1986
Rep. of Korea	Securities and Exchange Commission
Taiwan Prov. of China	Securities and Exchange Commission
Thailand	Securities and Exchange Commission since 16 March 1992
Indonesia	Capital Market Agency, separated from stock exchange by Presidential Decree of 1990
Turkey	Capital Market Board since 1982
India	Securities and Exchange Board of India (SEBI) since 1988
Hungary	State Securities Supervision
Nigeria	Securities and Exchange Commission (SEC) since 1979
Panama	Comisión Nacional de Valores since 1970
Fragmented forms (several agencies)	
Mexico	(1) Ministry of Finance (policies and norms), (2) Mexican National Securities Commission (CNV, policies and norms) since 1946, (3) Bank of Mexico (government securities)
Brazil	(1) National Monetary Council (policies and norms), (2) Central Bank and (3) Securities Commission (CVM, supervision)
Malaysia	(1) Capital Issues Committee (new issues and listing), (2) Registrar of Companies (administration of securities act, dealer licences), (3) Foreign Investment Committee (regulation guidelines), (4) Panel on Take-Overs and Mergers, (5) Bank Negara Malaysia (government securities)

Table 10

Basic characteristics of restrictions on inward/outward securities investment in selected developing and eastern European countries (at the end of 1992)

Country	Inward investment into domestic securities		Restrictions on outward investment into foreign securities
	Restrictions on inward investment	Share of foreign ownership limited	
Bahrain	none	none	none
Hong Kong	none	none	none
Panama	none	none	none
Singapore	none	no	none
Jamaica	none since 1991	no	none since 1991
Tunisia	none, inward investment stimulated	no	not available
Uruguay	none, basically free	no	none, basically free
Egypt	free through authorized dealers or banks	no	free through authorized dealers or banks
Paraguay	free through local commercial banks or exchange houses	no	free through local commercial banks or exchange houses
Venezuela	information required	prohibited in petroleum sector	not available
Argentina	registration required	no	not available
Botswana	none, encouraged	no	prior approval
Peru	registration	gradual acquisition by nationals required	none
Thailand	equity and portfolio investment free through authorized banks	sectorally specific	prior approval
Kuwait	approval	to 49% in new companies but GCC nationals allowed to own up to 75%	listing of foreign companies in the Kuwait Stock Exchange subject to approval
Poland	registration	no	authorization
Turkey	securities trading through local intermediary free	no	approval
Bangladesh	up to 49% free, over 49% under approval	no	approval
Barbados	approval, facilitated for CARICOM nationals	no	approval, facilitated for intra-CARICOM investment
Colombia	up to 10% registration, over 10% approval	no	approval

Table 10 (continued)

Country	Inward investment into domestic securities		Restrictions on outward investment into foreign securities
	Restrictions on inward investment	Share of foreign ownership limited	
Ghana	approval	no	approval
India	up to 51%, investment in shares automatically approved	generally 51%, 35% in engineering, chemicals, food processing, 100% in high tech and power sectors	prior approval in certain categories
Malaysia	free up to 15%, prior approval over 15%	80% in certain sectors	prior approval
Zimbabwe	for individual investors, free through banking, for institutional investors not allowed	no	not available
Brazil	except for MERCOSUR nationals, only portfolio investment allowed after registration	no	generally, authorization required (facilitated for MERCOSUR nationals)
Costa Rica	prior authorization	no	prior authorization
Côte d'Ivoire	free with France and WAMU, otherwise authorization	no	free with France and WAMU, otherwise authorization
Cyprus	approval	5 to 49% depending on sector	authorization
Ecuador	authorization	no	authorization
Honduras	authorization and approval	no	authorization and approval
Hungary	none	no	non-automatic approval, selectively granted
Jordan	none	no	non-automatic approval, selectively granted
Rep. of Korea	approval	negative list (prohibitions and restrictions)	approval
Mexico	up to 49% free, over 49% prior authorization	prohibition in energy, transport and telecommunication, 40% in petrochemicals and car spare parts, 49% in others; exemptions granted	not available
Morocco	certain subject to prior authorization	in certain sectors	prior authorization
Philippines	prior and specific approval	generally 40%	prior and specific approval

Table 10 (continued)

Country	Inward investment into domestic securities		Restrictions on outward investment into foreign securities
	Restrictions on inward investment	Share of foreign ownership limited	
Trinidad and Tobago	approval, facilitated for CARICOM nationals	no	restricted but allowed in intra-CARICOM
Chile	in the form of foreign capital investment funds, authorization	no	not available
Indonesia	generally restricted, approval required	generally 49%, in new investment up to 80% may be authorized	not available
Pakistan	generally free, in certain areas approval required	no	generally not permitted
Sri Lanka	only channel (commercial bank) prescribed up to 40% of shares, also prior approval over 40%	no	generally not permitted
Nigeria	approval	sector-specific ceilings	outward securities investment prohibited

Source: IMF [1992a].

Table 11: Restrictions on capital movements reserved by OECD member States in the Code of Liberalisation of Capital Movements as of March 1992

	Admission of domestic securities on a foreign capital market				Admission of foreign securities on the domestic capital market				Operations in the country concerned by non-residents				Operations abroad by residents			
	Issue through placing or public sale of		Introduction on a recognized foreign security market of		Issue through placing or public sale of		Introduction on a recognized foreign security market of		Purchase		Sale		Purchase		Sale	
	shares and other securities of a participating nature	bonds or other debt securities (maturity >one year)	shares and other securities of a participating nature	bonds or other debt securities (maturity >one year)	shares and other securities of a participating nature	bonds or other debt securities (maturity >one year)	shares and other securities of a participating nature	bonds or other debt securities (maturity >one year)	shares and other securities of a participating nature	bonds or other debt securities (maturity >one year)	shares and other securities of a participating nature	bonds or other debt securities (maturity >one year)	shares and other securities of a participating nature	bonds or other debt securities (maturity >one year)	shares and other securities of a participating nature	bonds or other debt securities (maturity >one year)
Denmark	none	none	none	none	none	none	none	none	none	none	none	none	none	none	none	none
Italy	none	none	none	none	none	none	none	none	none	none	none	none	none	none	none	none
Luxembourg	none	none	none	none	none	none	none	none	none	none	none	none	none	none	none	none
Netherlands	none	none	none	none	none	none	none	none	none	none	none	none	none	none	none	none
UK	none	none	none	none	none	none	none	none	none	none	none	none	none	none	none	none
Ireland	none	none	none	none	none	none	none	none	none	none	none	none	none	on certain bonds	none	none
France	none	euro-franc issues	none	none	none	none	none	none	non-EU residents buying unquoted		none	none	none	none	none	none
Belgium	none	none	none	none	none	non-EU origin	none	non-EU origin	none	none	none	none	none	none	none	none
Germany	none	German-Mark-denominated	none	none	none	German-Mark-denominated	none	none	none	German-Mark-denominated	none	none	none	none	none	none
Spain	none	non convertible bonds	none	none	all	all	none	none	affected by investm. laws	none	none	none	none	none	none	none
Portugal	all	all	not listed domestically	all	except those of international organizations		only securities not quoted at home		affected by investm. laws	if unquoted	none	if unquoted	open-ended inv. funds	unquoted escudo-denominated	none	if unquoted
Greece	unlisted, drachma-denom. securities outside EU		none	if maturity < 2 years	unquoted securities of non-EU residents		unquoted securities of non-EU residents		unquoted securities of non-EU residents		sale by non-EU residents of unquoted securities		except EU-listed securities of EU companies		only domestic securities not listed abroad	
Norway	none	none	none	none	none	none	none	none	affected by investm. laws	none	none	none	none	none	none	none

Table II (continued)

	Admission of domestic securities on a foreign capital market				Admission of foreign securities on the domestic capital market				Operations in the country concerned by non-residents				Operations abroad by residents			
Sweden	none	none	none	none	none	none	none	none	affected by investm. laws	none	none	none	none	none	none	none
Switzerland	none	only Swiss-franc denom.	none	none	higher stamp duty on foreign securities		none	none	none	none	none	none	none	none	none	none
Finland	none	none	none	none	none	none	none	none	affected by investm. laws	none	none	none	mutual funds limited to hold 20% of portfolio abroad		none	none
Austria	none	all	none	none	none	all	none	none	none	none	none	none	none	none	none	none
Japan	none	none	none	none	none	none	none	none	none	none	waiting period for yen-related securities		none	none	none	none
New Zealand	none	none	none	none	none	none	none	none	Air NZ limited to nationals	none	none	none	none	none	none	none
Canada	none	none	none	none	none	none	none	none	affected by investm. laws	none	none	none	none	none	none	none
Turkey	none	none	none	none	all	all	all	all	none	none	none	none	only unquoted foreign non-government securities		none	none
USA	none	none	none	none	for investment companies	none	for investment companies	none	affected by investment laws	none	none	none	none	none	none	none
Australia	none	none	none	none	foreign government entities and international organisations		foreign government entities and international organisations		affected by investm. laws	none	foreign government entities and international organisations		none	none	none	none

Notes:
1/ Liberalisation obligations for admission of foreign securities on the domestic capital market are subject to the regulations of the security market concerned.
2/ Liberalisation implies that authorities of Members do not maintain or introduce measures that discriminate against foreign securities.
3/ Members may require transactions to be carried out through authorized resident agents.
4/ Members may require the cross-border holding of funds and securities through the intermediary of authorized resident agents.
5/ Members may require transactions to be carried out only on a spot basis.
6/ In regard with sales in the country concerned by non-residents, Members may take non-discriminatory investor protection measures. In regard of purchase abroad by residents, Members may regulate promotional activities carried out in their territory.

Source: *Code of Liberalisation of Capital Movements*, OECD, Paris, 1992

ANNEX II

GLOSSARY

American Depository Receipts: A certificate registered in the holder's name or as a bearer security giving title to a number of shares in a non-United States based company. These certificates are traded on United States stock exchanges.

Bills of exchange: Refers to an order in writing addressed by one person to another signed by the person giving it, requiring the person to whom it is addressed to pay, on demand or at a fixed date, a specified sum of money. Bills are negotiable in the money market, so enabling drawers to obtain their money at once. Bills of exchange are divided into different categories, such as, bank bills, trade bills, fine trade bills and finance bills.

Broker: An intermediary between a buyer and a seller in a highly organized market. Broker-dealer: person or organization buying and selling securities, commodities and contracts both on their own account and as an agent for clients.

Capital adequacy: Refers to the minimum capital requirements set by various regulatory bodies for financial institutions. With the increasing globalization of the world financial system, international agreement on capital adequacy standards are required. In December 1987, 11 countries of the European Union signed an international agreement for capital adequacy for commercial banks under the auspices of the Bank for International Settlements (BIS). The agreement provided for common prudential ratios and a common definition of risk-adjusted assets. Banks operating in signatory countries needed to have capital (equity and long-term debt) equal to 8 per cent of risk-adjusted assets (liquidity ratio).

Capital gain: A realized increase in the value of a capital asset, as when a share is sold for more than the price at which it was purchased. The taxation of capital gains varies between countries and between individuals and companies. Traditionally, for individuals, capital gains are taxed at a lower rate than income. Some countries tax short-term and long-term gains at different rates, while few do not tax capital gains at all. The rationale for this is, among other reasons, that some or all capital gains may be the result of inflation.

Capital market: Refers to the market for longer-term loanable funds as distinct from the money market, which deals in short-term funds. There is no clear-cut distinction between the two markets although, in principle, capital market loans are used by industry and commerce for fixed investment and acquisitions. The capital market is an increasingly international one and in each country it consists of all those institutions that channel the supply and demand for capital, including the banking system, the stock exchange, insurance companies and other financial intermediaries.

Clearing of securities transactions: The offsetting of liabilities or purchases and sales between two or among many parties.

"Country Fund": Fund which specializes in making investments in a particular country, region or in selected emerging markets. Closed-end funds have a limited number of shares which can usually only be increased with the consent of fund holders. Closed-end funds therefore operate very much like a limited liability company. The value of a fund share may reflect a market value in addition to the underlying asset value and would be traded in the open market rather than redeemed by the manager. Eventually, with stockholders' consent, closed-end funds may be changed into open-ended ones. The latter can issue and redeem shares to meet investor demand.

Cross-border: Transactions in domestic shares, conducted in the domestic market, by or on behalf of foreign non-residents.

Cross-exchange trading: Transactions in foreign shares, conducted either on the investor's local exchange, or on another specialist exchange. Cross-exchange trading refers to transactions in foreign shares, conducted in the foreign market, by or on behalf of domestic residents.

Cross-border listing: Securities of the same company listed simultaneously on stock exchanges of more than one country.

Dealer: Someone who buys and sells on his/her own account.

Derivatives: Contracts which give one party a claim on an underlying asset (or its cash value) at some point in the future, and bind a counterparty to meet a corresponding liability. The contract might describe an amount of currency, or a security, or a physical commodity, or a stream of payments, or a market index. It might bind both parties equally (futures), or offer one party an option to exercise it or not (options). Some derivatives can be traded on exchanges; their market price will depend in part on the movement of the price of the underlying asset since the contract was created. Whereas OTC contracts are tailored-made by the intermediaries to fit the end-users' needs, exchange-traded contracts have standardized maturity, contract size and delivery terms, and the exchange itself is the counterparty in each transaction.

Equity: The residual value of a company's assets after all liabilities (other than those to holders of ordinary shares) have been allowed for. The equity of a company is the property of the ordinary shareholders.

Financial futures: Instruments designed to protect against risks of losses. They consist of purchases or sales at a determined price specifying a given future date.

Gross equity flows: The gross purchases plus the gross sales of equity securities. Gross equity flows represent the value of overall trading and are a measure of trading volume within the market. Net equity flows are the gross purchases minus the gross sales of equity securities. It is a measure of the flow of new money into the market.

Insider trading: occurs when someone trades in the shares of a company to his or her personal gain while in possession of confidential information on current developments or future events concerning that company which information has not yet been released to the public.

Investment funds: funds constituted by shareholders which have been gathered by a public call for collective investment. They are managed at the account of the shareholders based on a principle of risk-sharing.

Market capitalization: Market value of all listed companies at the end of the period. The market value of a company is usually defined as the share price times the number of shares outstanding.

Money market: Market in short-term (normally up to one year) financial claims, for example, bills of exchange, treasury bills, interbank money and discount house deposits.

Options: Contracts between clients and banks that give the client the right to buy (call) or sell (put) a determined number of shares or bonds of a given enterprise in a fixed period. These buying and selling rights are tradable during the whole period preceding the validity of options but lose their value when the option is to be realized.

Over-the-counter (OTC) market: The term refers to a group of licensed dealers who provide two-way trading facilities in company securities outside the stock exchange. OTC markets tend to rely on elaborate electronic dealing systems, with market makers across their home country. The companies traded in the market may be either listed on the stock exchange or not. If the securities are unlisted, the OTC market may be also called a *parallel market*.

Parallel market: A second-tier unlisted securities market. It is often used as a synonym for the unlisted segment of the *over-the-counter (OTC) market*.

Price-earnings (P/E) ratio (***PER***, also known as the multiple): The quoted price of a share divided by the most recent year's earnings per share (net of tax dividends plus retained earnings/undistributed profits). High PERs reflect favourable investor assessment of the future earning power of the company.

Rotating savings and credit association (ROSCAs): Informal groups of 6 to 40 participants who regularly (for example, monthly) make a contribution into a fund that is given in rotation to each group member.

Settlement: Payment of an obligation, for example, a payment in cash for securities.

Stock Exchange: Market in which securities are bought and sold. They facilitate savings and investment by enabling investors to dispose of securities quickly if they wish to do so (in the secondary market) and for companies, Governments and organizations to raise new capital in the primary market (new-issue market).

Underwriter: Financial agent that guarantees buyers or finds buyers for all or part of the issue of a security, in return for a fee by a bank or group (syndicate) of banks to ensure sale of any part of an issue that is not bought by the public to which it is directed.

Unit trust: Represents a method of investment whereby money subscribed by several people is pooled in a fund, the investment and management of which is embodied in the legal provision of a trust deed (made between a management

company and a corporate trustee for the benefit of beneficiaries). The fund is invested in securities on behalf of the subscribers (more commonly known as unit holders) by a management company. The management company and the trustee (in whose favour the trust deed is constituted) must be independent of each other.

Universal banking: The maximum extension of commercial banks' scope of activities. Traditionally, banks are distinguished by their role in deposit taking. In most countries, these activities may be eventually supplemented by such services as insurance, credit cards and foreign exchange but investment banking and equity holding are not allowed. In contrast with this general form of regulation, in countries with *universal banking* (for example, Germany, Netherlands and Switzerland) banks are allowed to act as investment banks and provide a wide range of other financial services including equity trading.

Warrants: Securities giving the holder a right to subscribe to a share or a bond at a given price and from a certain date. They do not carry any income or other rights to equity; they trade separately on the stock exchange at a price lower than that of the associated security.

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